DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of inspector General

Memorandum

Date · MAR 27 1996

From Deputy Inspector General
for Audit Services

Subject Audit of Administrative Costs - Parts A and B and Railroad Retirement Board Provisions of the Medicare Program - Travelers Insurance Company (A-01 -96-O0508)

To Steven A. Pelovitz
Associate Administrator
for Research and Management, HCFA

This memorandum is to alert you to the issuance on March 27, 1996 of our final report. A copy is attached.

This report presents the results of the certified public accounting firm, Tichenor & Associates' audit of costs claimed on Travelers final administrative cost proposals for Parts A and B and the Railroad Retirement Board provisions of the Medicare program for the Fiscal Years 1990 through 1993. We have performed sufficient work to satisfy ourselves that the attached audit report can be relied upon and used by the Health Care Financing Administration in meeting its program oversight responsibilities.

We are recommending a financial adjustment of $2,803,620 of the costs claimed because Travelers:

- claimed $1,209,868 for unallowable facilities and occupancy costs. The costs were applicable to space in excess of the maximum square footage permitted under the Medicare agreements;

- charged Medicare $1,777,365 for the current audit period for various corporate cost centers that were determined to be unallowable in the prior audit report of Travelers claim for administrative costs;

- allocated $493,634 for various corporate cost centers which were unallowable allocations to the Medicare program;

- understated credits by $201,400 for processing complementary insurance claims;

- understated the claim for return on investment by $15,365 due to error in the calculation; and

- is entitled to an additional $863,282 in incentive payment fees because of a decrease in allowable administrative costs resulting in a greater difference between actual costs of processing Medicare claims and the established target amount.

In its response, Travelers disagreed with the recommended adjustments for facility and occupancy costs and the costs related to the prior report disallowances. Travelers agreed with the remaining audit adjustments.

Thomas D. Roslewicz

For further information, contact:

Richard J. Ogden
Regional Inspector General
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(617) 565-2689

Attachment

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

AUDIT OF ADMINISTRATIVE COSTS - PART A & B AND RAILROAD RETIREMENT BOARD PROVISIONS OF THE MEDICARE PROGRAM - TRAVELERS INSURANCE COMPANY

JUNE GIBBS BROWN
Inspector General

MARCH 1996
A-01-96-00508

REPORT ON

AUDIT OF ADMINISTRATIVE COSTS INCURRED UNDER

PART A OF THE MEDICARE PROGRAM

FOR THE PERIOD

OCTOBER 1, 1989 THROUGH SEPTEMBER 30, 1993

BY

THE TRAVELERS INSURANCE COMPANY

HARTFORD, CONNECTICUT

NOTICE

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of Tichenor & Associates, Certified Public Accountants, as concurred in by the HHS OIG Office of Audit Services. Final determinations on these matters will be made by authorized HHS operating division officials.

TABLE OF CONTENTS

PAGE

SUMMARY i

INTRODUCTION 1
Background 1
Regulations Relating to Cost Reimbursement 2
Scope of Audit 3

FINDINGS AND RECOMMENDATIONS 4
Unallowable Facility and Occupancy Costs 4
Follow Up OfPrior Audit Findings 6
Unallowable Indirect Costs... 13
Additional Incentive Payments. 16

OTHER MATTERS 18
Follow-Up On Prior Audit Report Findings 18
Interim Expenditure Report 18
Complementary Insurance Credit... 19
Significant Electronic Data Processing Expenditures 19
Areas of Audit Concer n....... 20

INDEPENDENT AUDITOR'S REPORT 21

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL 23

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE 27

FINAL ADMINISTRATIVE COST PROPOSALS 29
Exhibit l- Fiscal Year 1990 30
Exhibit 2- Fiscal Year 1991 31
Exhibit 3- Fiscal Year 1992 32
Exhibit 4- Fiscal Year 1993.. 33

APPENDIX - Intermediary's Written Response to Findings and Recommendations . . . 34

CONTRACT DISCLOSURE STATEMENT

This report is made pursuant to Contract HHS-1OO-91 -0030 with Tichenor & Associates, Certified public Accountants, 12531 Clipper Drive, Suite 202, Woodbridge, Virginia, 22192. Certain information contained herein is subject to disclosure under the Freedom of Information Act, 5 U.S.C. 522(b)4). The Task Monitor was Mr. Robert Champagne, HHS Office of Inspector General, Room 515, 450 Main Street, Hartford, Connecticut, 06103.

The names of the persons employed by Tichenor & Associates, with managerial or professional responsibility for such work, or for the content of the report, are as follows:

Jonathan Crowder, CPA
Deirdra McKenna, CPA
Edward Noble, CPA
Kenneth Wachner, Sr. Auditor

SUMMARY

The Travelers Insurance Company (the Intermediary) claimed administrative costs totaling $20,146,512 on its Medicare Part A Final Administrative Cost Proposals (FACPs) for fiscal years ended September 30, 1990, 1991, 1992, and 1993. Our audit disclosed questioned costs of $220,137 and additional incentive payments of $57,481 due to the Intermediary based on the questioned costs. The audit findings are summarized as follows:

- The Intermediary claimed $106,838 of unallowable facilities and occupancy costs which exceeded 135 net-usable square feet per equivalent man-year as allowed by the contract. Also, the Intermediary allocated facility and occupancy costs based on budgeted rates rather than actual rates.

- The Intermediary claimed current costs of $74,978 for indirect costs which were identified as unallowable during prior audits of Medicare administrative costs. Claiming costs which were previously identified as unallowable is unallowable in accordance with the Medicare agreement, Article XIII, paragraph L. These unallowable indirect costs included $56,585 for vacant space which is unallowable in accordance with FAR 31.205-17, $34,693 for certain leased equipment which is unallowable in accordance with FAR 31.201-4, $3,094 for tax planning which is unallowable in accordance with FAR 31.205-41(b)(1) and 31.205-27(a), and $(19,394) for pension contributions which are unallowable in accordance with FAR 31.205-6 and Cost Accounting Standards (CAS) 412.40.

- The Intermediary claimed $38,321 in unallowable indirect costs including (1) cost centers that do not benefit Medicare, (2) costs not incurred, (3) unsupported costs, (4) unallowable costs, and (5) cost centers inconsistently allocated.

- The Intermediary was entitled to and received an incentive fee in fiscal years 1992 and 1993. However, the incentive fee paid was based on the administrative costs per claim as calculated by the Intermediary. This claimed per unit cost included unallowable administrative costs as summarized above. Reducing the administrative costs by the above questioned costs resulted in a lower per unit cost and therefore an additional incentive fees of $57,481.

We evaluated the Intermediary's system of significant internal accounting and administrative controls and its compliance with laws and regulations that can materially affect the Intermediary's FACPS. Our evaluation, in addition to the above recommended adjustments, disclosed internal control weaknesses in the inventory control and travel expense systems;

however, we identified no specific financial impact. Otherwise, we believe control procedures were generally adequate for the Department of Health and Human Services' (HHS) purposes, and that the Intermediary complied with the terms and provisions of laws and regulations for the transactions tested. Tichenor & Associates' reports on its reviews of internal control and on compliance appear on pages 23 and 27, respectively.

We held a departure conference with Intermediary representatives on November 22, 1994, the date we concluded our field work. The Intermediary was provided with a copy of the draft audit report, to which they provided written comments, included as an Appendix to this report. We incorporated those comments into the final report. The Intermediary concurred with a portion of the total questioned costs such as unallowable indirect costs and understated facility and occupancy costs. The intermediary, however, disagreed with the remaining cost findings and recommendations. The Intermediary also concurred with all of our internal control findings and recommendations except for periodic inventories of assets with which they did not agree, The Intermediary's response is included as an Appendix to this report.

INTRODUCTION

The information contained in this report relates to an audit of administrative costs incurred under Title XVIII, Part A, of the Social Security Act by The Travelers Insurance Company (the Intermediary) during the four-year period O-ctober 1, 1989 through September 30, 1993.

BACKGROUND

Health Insurance for the Aged and Disabled (Medicare), Title XVIII of the Social Security Act, provides a hospital insurance program and a related medical insurance program for (a) eligible persons aged 65 and over; (b) disabled persons under 65 who are entitled to Social Security or Railroad Retirement disability benefits for at least 24 consecutive months; and (c) individuals under 65 with chronic kidney disease who are currently insured by or entitled to Social Security benefits.

The hospital insurance program, Part A, Hospital Insurance Benefits for the Aged and Disabled, provides protection against the costs of hospital in-patient care, post-hospital extended care, and post-hospital home health care. The Medicare program is administered by the Health Care Financing Administration (HCFA). Title XVIII provides, however, that public or private organizations, known as intermediaries (Part A), may assist in administering the Medicare program under contracts or agreements with HCFA for processing bills and making payments that are due under the program.

Intermediaries are reimbursed for all reasonable and allowable costs incurred in administering the programs, except for specific limitations that may be agreed to in the individual Medicare contracts and agreements. During the four-year period covered by our audit, Travelers Insurance Company served as the intermediary in administering Medicare Part A claims for portions of three (3) states: Connecticut, Michigan and New York.

During the audit period, October 1, 1989 through September 30, 1993, the Intermediary processed about 3.4 million Medicare Part A claims totaling about $2.225 billion and claimed administrative costs of $20.1 million for this period as follows:

Period	Claimed costs	Claims Processed
10/1/89 - 9/30/90	$ 5,417,798	770,315
10/1/90 - 9/30/91	4,783,609	802,668
10/1/91 -9/30/92	4,939,028	894,280
10/ 1/92 - 9/30/93	5,006,077	932,513
TOTAL	$ 20,146,512	3,399,776

Costs incurred inconnection with the Intermediary's activities are accumulated in cost centers which are subsequently allocated to its various lines of business, including its Medicare Part A line of business.

REGULATIONS RELATING TO COST REIMBURSEMENT

Article XII of the Medicare agreement states that allowable costs under the agreement shall be determined in accordance with the provisions of Part 31 of the Federal Acquisition Regulation (FAR) as interpreted and modified by Appendix B to the agreement. Section 31.201-1 of the FAR provides that the total cost of a contract is the sum of the allowable direct and indirect costs allocable to a contract, incurred or to be incurred, less any applicable credits.

FAR Part 31 also provides that items of cost are allowable charges provided that the tests of reasonableness and allocability are met and that generally accepted accounting principles are followed. A reasonable cost is defined as one that would be incurred by an ordinarily prudent person in the conduct of competitive business. Further, a cost is allocable if it is assigned or chargeable to a particular cost objective in reasonable proportion to the benefits received.

Sections 31.202 and 31.203 of the FAR define direct and indirect costs as follows:

> Direct Costs: Any cost that can be identified specifically with a particular cost objective. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly thereto. Costs identified specifically with other work of the Intermediary are direct costs of that work and are not to be charged to the contract directly or indirectly.
>
> Indirect Costs: Any cost that, because of its incurrence for common or joint objectives, is not readily subject to treatment as a direct cost.

Finally, Section 31.205 of the FAR provides detailed guidelines as to whether or under what circumstances specific types of costs are allowable or unallowable.

SCOPE OF AUDIT

We audited the Medicare Part A Final Administrative Cost Proposals (FACPs) of The Travelers Insurance Company (the intermediary) for the period October 1, 1989 through September 30, 1993. The FACPs are the responsibility of the intermediary's management. Our responsibility is to express an opinion on these FACPs based on our audit.

Our examination was made in accordance with generally accepted auditing standards and with the *Government Auditing Standards (1988* Revision) issued by the Comptroller General of the United States. The primary purpose of the examination was to express an opinion as to whether the Intermediary's FACPS present fairly the allowable costs of administration in conformity with the reimbursement principles contained in Part 31 of the FAR as interpreted and modified by the Medicare agreement. The examination included an evaluation of the accounting system and related internal controls, tests of the accounting records, and the application of the auditing procedures contained in the *Audit Guide for the Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers Under Title XVIII of the Social Security Act* (Audit Guide) issued by the Department of Health and Human Services Office of Inspector General in March, 1991. However, at the direction of the Department of Health and Human Services (HHS), Office of Inspector General (OIG), we did not audit the Intermediary's pension plans.

The audit fieldwork was conducted at The Travelers Insurance Company, Hartford, Connecticut, during the period August 15, 1994 through November 22, 1994.

This report is intended solely for the purpose described above and should not be used for any other purpose.

FINDINGS AND RECOMMENDATIONS

For the period October 1, 1989 through September 30, 1993, the Intermediary claimed administrative costs totaling $20,146,512 on its Medicare Part A FACPS. Our audit disclosed questioned costs of $220,137 as unallowable and additional incentive payments of $57,481 due to the Intermediary in accordance with applicable Federal regulations and the terms and conditions of the Medicare agreement as follows.

Summary of Claimed and Questioned Costs 10/1/89 through 9/30/93			
Period	Claimed costs	Questioned costs	Reference
10/1/89 - 9/30/90	$ 5,417,798	$ 116,840	Exhibit 1
10/1/90 - 9/30/91	4,783,609	(64,260)	Exhibit 2
10/1/91 - 9/30/92	4,939,028	92,907	Exhibit 3
10/1/92 - 9/30/93	5,006,077	17,169	Exhibit 4
TOTAL	$ 20,146,512	$ 162,656	

Our detailed findings and recommendations are also discussed below.

UNALLOWABLE FACILITY AND OCCUPANCY COSTS

The Intermediary claimed $106,838 of facility and occupancy (F&O) costs for space exceeding 135 net-usable square feet per equivalent man-year. The allocation of space in excess of 135 net-usable square feet per equivalent man-year is unallowable in accordance with Appendix B, Section X. B. 1. to the Medicare contract. which states:

> "With respect to space, either leased or owned, acquired after the effective date of this agreement/contract, the guideline for the amount of such space which may hereafter be allocated for the performance functions under this agreement/contract to the Medicare program, without justification by the contractor, shall be an average of 135 square feet of net usable space per equivalent man-year.

Additional amounts of space may be allocated, provided that the contractor justifies such additional amounts. ”

We determined that the Intermediary has not submitted a request to HCFA justifying the allocation of greater than 135 net-usable square feet per equivalent man-year to the Medicare program. We also determined that the Intermediary had allocated indirect facility costs based on budgeted average costs per square foot which were not adjusted to actual. We determined that budgeted and actual indirect facility costs per square foot were as follow:

Fiscal Year	Budgeted/Claimed Rate	Actual Rate
1990	$24.14	$25.09
1991	$24.44	$25.04
1992	$21.45	$21.75
1993	$21.26	$22.32

The use of budgeted rates versus actual rates resulted in an understatement of the indirect facility costs. Therefore, we calculated the total actual F&O costs using the actual rates shown above. We then calculated the unallowable F&O costs by determining the excess square feet allocated to Medicare and multiplying it by the average cost per square foot for the Intermediary’s home offices. The results of the calculations were netted together to determine the total unallowable costs. Our audit disclosed unallowable facility and occupancy costs of $106,838 as follows:

Fiscal Year	Totat F&O costs	Total Sq. Ft. Allocated	Excess Sq. Ft.	Questioned costs
1990	$ 596,855	145	10	$ 27,467
1991	442,440	141	6	10,840
1992	490,363	155	20	49,578
1993	429,904	146	11	18,953
TOTAL	$ 1,959,562			$ 106,838

Recommendation

We recommend that the Intermediary reduce the fiscal year 1990, 1991, 1992 and 1993 FACPs by their respective share of the $106,838 for unallowable facility and occupancy costs claimed.

Intermediary's Response

The Intermediary summarized their positional follows:

> "This audit finding is comprised of two issues: the use of budgeted versus actual rates which caused costs to be understated . . . and excess square footage. The net amount . . . was questioned in the audit reports.
>
> We agree with the audit finding relative to the use of budgeted versus actual rates which resulted in an understatement of costs for the four fiscal years . . . .
>
> We disagree with the second component of the finding that recommends disallowance of net usable square feet in excess of the contractual 135 square feet on the basis that the Government is estopped from retroactively requiring Travelers to include corporate home office space in the calculation of net usable square feet. In addition to that argument, we have also included justification for the additional post-1978 space and maintain that space acquired prior to 1978 should have been excluded from the auditor's calculation but was not . ..."

Auditor's Additional Comments

Although the Intermediary stated that the Government has previously not required the inclusion of corporate home office space in the calculation of total facility and occupancy costs subject to the 135 square foot limitation, we have determined that the facility and occupancy finding developed in a prior audit of fiscal years 1984 and 1985, were consistent with our basis. Furthermore, our findings were developed in accordance with Appendix B to the Medicare agreement. The final determination as to the allowability of the questioned facility and occupancy costs is a legal matter which is outside of the scope of our audit. Therefore, we continue to include the applicable corporate home office space in the calculation of net usable square feet. We concur that space that was acquired, and not modified through lease amendment, prior to October 1978 should not be included in the calculation of net usable square feet and the personnel residing in that space should not be included in the calculation of the net equivalent man years. The Intermediary provided additional data to support the calculation of these items. We considered and evaluated this information in determining the revised allowable and unallowable costs.

FOLLOW UP OF PRIOR AUDIT FINDINGS

The Intermediary claimed $74,978 for indirect costs which were identified as unallowable during prior audits of Medicare administrative costs. The fiscal year 1988-1989 audit questioned costs claimed for allocated vacant space, tax planning costs, leased equipment costs and pension contributions. These findings were sustained by HCFA as documented in the Audit Clearance

Document dated December 16, 1991. However, the Intermediary did not concur with the finding or determination and, according to HHS OIG, has appealed the decision.

The Medicare contract, Article XIII, paragraph L., states:

> "If the Secretary and the Intermediary are unable to agree upon a final amount of the administrative costs of the Intermediary for a particular period, the Secretary shall issue a final determination of the amount of such administrative costs for such period and inform the Intermediary of such costs, with a full explanation of the exceptions he has taken to the Intermediary's report of its allowable costs. If a dispute arises as to the exceptions taken by the Secretary, the Intermediary may appeal the final determination in accordance with the provisions of Article XXI of this agreement . . . . Where a particular cost or type of cost is disallowed by final determination of the Secretary and the Intermediary is not in agreement with the Secretary's disallowance, the Intermediary will, for subsequent claims, abide by the decision of the Secretary and agrees not to be reimbursed, pending resolution of any amounts of such costs. Until the issue is resolved, the Intermediary will segregate such costs from all others, and specify the amounts of such costs on all subsequent claims. " (Emphasis added)

Therefore, these costs should have been specifically identified by the Intermediary as not reimbursable pending the outcome of the appeal process. The unallowable costs were identified as follows:

Cost Category	1990	1991	1992	1993	Total	Note
Vacant Space	$ 23,539	$ 12,169	$ 10,539	$ 10,338	$ 56,585	(1)
Leased Equipment	13,075	11,462	6,276	3,880	34,693	(2)
Tax Planning	1,070	650	719	655	3,094	(3)
Pension Contributions	47,982	(102,612)	50,684	(15,448)	(19,394)	(4)
TOTAL	$ 85,666	$ (78,331)	$ 68,218	$ (575)	$ 74,978	

Note:

(1) Vacant Space

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Intermediary allocated costs to the Medicare program for vacant space. We determined that the Intermediary claimed $56,585 for vacant space in fiscal years 1990 through 1993. The allocation of idle facilities and idle capacity costs to the Medicare contract are unallowable in accordance with FAR 31.205-17 which states:

> "The costs of idle facilities are unallowable... "

Therefore, we continue to classify the costs claimed for vacant space as unallowable under the current Medicare program.

(2) Leased Equipment

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Intermediary allocated costs to the Medicare program for leased equipment which did not benefit the Medicare program. We determined that the Intermediary claimed $34,693 for leased equipment which they could not demonstrate benefitted the Medicare contract in fiscal years 1990 through 1993. The allocation of costs to the Medicare contract is unallowable in accordance with FAR 31.201-4 if no benefit is received by the program.

Therefore, we continue to classify the costs claimed for leased equipment which does not benefit the Medicare program as unallowable under the current Medicare program.

(3) Tax Planning

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Intermediary allocated costs to the Medicare program from cost center 115-400, Tax Planning. We determined that the Intermediary claimed $3,094 for the tax planning cost center in fiscal years 1990 through 1993. This cost center is responsible for Federal, State and foreign tax planning, development of tax policies relating to tax laws, and the acquisition of companies or business segments. FAR 31.205-41 (b)(1) states:

> "The following types of costs are not allowable: (1) Federal income and excess profit taxes. "

Also, FAR 31.205-27(a) states, in part:

> ". . . expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business including mergers and acquisitions . . . are unallowable. "

Therefore, we continue to classify the costs claimed for the Tax Planning cost center as unallowable under the current Medicare program.

(4) Pension Contributions

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Intermediary claimed costs under the Medicare program for unfunded nonqualified pension contributions. We did not perform a review of the pension costs claimed by the Intermediary. However, during our review of the prior audit findings and our determination of their disposition, we determined that the Intermediary had continued to claim unallowable pension costs as reported in the prior audit. The Intermediary provided the amount, by fiscal year, which had been claimed but was unallowable for fiscal years 1990 to 1993. These amounts included credits for fiscal years 1991 and 1993.

The Intermediary stated that the credits are due to timing differences created due to the reporting period, calendar year versus fiscal year, and the funding of an unqualified pension plan which is adjusted on a calendar basis and may include credits from prior periods. We did not determine whether the amounts provided by the Intermediary were supported by the accounting records since pension costs had been excluded from the scope of our audit. However, we recommend that HCFA verify that the amounts, including the credits, are accurate.

The Intermediary claimed $(19,394) for the same unqualified pension contributions in fiscal years 1990 through 1993. FAR 3 1.205-6(j)(2)(ii) does not allow costs of pension plans that are discriminatory to the Federal Government. Medicare is the only line of business currently funding its entire share of the pension plan. The costs of the plan for other lines of business are accrued but not funded until benefits are due to participants. This practice is discriminatory to the Federal Government. In addition, the Cost Accounting Standards (CAS) 412.40 (c) do not allow the cost of pension plans if the payment of benefits from the plan cannot be compelled by the participants. The Intermediary could not clearly illustrate that the benefits under the nonqualified plan can be legally compelled. The unallowable costs are the difference between the excess pension costs claimed over the pension costs funded.

Recommendation

We recommend that the Intermediary reduce the fiscal year 1990, 1991, 1992 and 1993 FACPs by their respective share of the $74,978 for unallowable costs which continue to be claimed although they have been identified as unallowable in prior audits.

Intermediary's Response

The Intermediary disagreed with the finding and recommendation. The Intermediary stated, in part:

> ".. .These issues were under dispute from the audit of fiscal years 1988 and 1989 . . . . these costs were not audited during the current audit. We were requested to quantify the costs that were claimed during the four fiscal years and were informed that Tichenor & Associates could not render an opinion as to the allowability of these costs, but that these cost issues would be decided based on the resolution of the fiscal years 1988 and 1989 dispute.

We recently reached a tentative settlement with HCFA on these four issues and propose that these costs in fiscal years 1990 through 1993 be resolved similarly. We support the decision made by HCFA related to the allowability of these costs. Each of the four items is addressed below:

A. Vacant Space

These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. Our reasoning is restated below:...

. . . the FAR permits the allowability of idle facilities costs when they are necessary to meet fluctuations in workload, or when they were necessary when acquired and are now idle because of reasonably unforeseen changes in requirements . . . .

Travelers vacant space costs are allowable under these express cost allowability principles. The Travelers vacant space policy[1] is that rent is charged to the Vacant Space cost center when a "tenant" (a Travelers Department or unit) moves out of an area as a result of a Corporate directive and in accord with the Master Space Plan (MSP). . . .The vacant space cost center is also used when tenants are moved to temporary space while their permanent location is renovated. The tenant is charged for the temporary space while the area under renovation is charged to vacant space. Thus, Travelers vacant space involves both idle capacity as well as idle facilities.

As can be seen from Travelers' vacant space policy, the vacant space charges relating to idle facilities arise from changed requirements, reorganization changes, production economies, and other causes, all of which Travelers takes into consideration under its MSP in assigning space. In addition, the vacant space charges arising from idle capacity are clearly the result of normal business fluctuations, not subject to reduction or elimination, such as when space is being renovated.

B. Lease Equipment

These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. Our reasoning is restated below:...

[1]Travelers set forth this policy and additional explanation on these costs in its May 30th, 1991 response to the draft audit report.

. . . in mid-1988, Travelers chose to lease, rather than purchase, its ADP equipment needs. This option offered Travelers certain financial advantages.

When Travelers made lease payments to the lessor, Travelers booked the amortized equipment amount to the responsibility code which "manages" the equipment repayment. The costs are built into the charge rates of the Data Center, and are allocated to Medicare based on the usage of the DP cost centers. . . .Thus, Medicare bore its proportional share of an allowable and necessary business expense.

c. Tax Planning

These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. Our reasoning is restated below:...

. . the Tax Planning Center is occasionally involved in analyzing the tax consequences of the proposed acquisition or disposition of various business segments or subsidiaries, its role does not extend to the "planning or execution of the organization or reorganization" of a business as described in FAR $31.205-27 . . . .

Second,. . .The costs of preparing and submitting business tax forms are expressly allowable under FAR $31.205 -28,....

. . .Thus, the Tax Planning Center costs associated with filing Federal Income tax forms are expressly allowable costs under FAR $31.205-28.

D. Pension Contributions

We propose settling on the unqualified plan using the same methodology that was used to settle this issue for fiscal years 1988 and 1989. Ron Solomon, HCFA, OACT, in his memo dated April 28, 1994, recommended that, "Since ultimate payment of accrued, but not projected, benefits is secured by the amendments, the government will consider accrual costs for the value of only the accrued benefits as allocable and allowable contract costs without regard to funding. This recommendation is to apply to costs for all years beginning with fiscal year 1987, notwithstanding the fact that the FAR change was not effective until fiscal year 1990. "

For the four fiscal years, we claimed a total of $48,682 on our FACPS . The revaluation by our actuaries indicates that the total allowable cost for the period was $771,929. Therefore, we understated our costs by $723,247 for FY 90 through 91. These additional costs should be considered as part of the settlement for these years. (Parts A, B, and RRB). ”

Auditor’s Additional Comments

A. Vacant Space

The Intermediary stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Intermediary did not provide any additional documentation to support that this decision had been changed.

In addition, the intermediary provided their Master Space-Plan policy stating that the only facility costs incurred for vacant space are those associated with changed requirements, reorganization changes, production economies and other causes which should be interpreted as allowable under FAR 31.205-17. However, we are aware of downsizing actions taken by the Intermediary as a result of corporate reorganizations planned, pending, or initiated, which result in permanent reductions and vacant space which is unallowable idle facility costs. Therefore, our finding and recommendation remain unchanged.

B. Leased Equipment

The Intermediary stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Intermediary did not provide any additional documentation to support that this decision had been changed.

The Intermediary did not address the allocability of the costs based on benefit, nor did they address how the leased equipment directly benefitted the Medicare program. Therefore, our finding and recommendation remain unchanged.

c. Tax Planning

The Intermediary stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Intermediary did not provide any additional documentation to support that this decision had been changed.

In a January 4, 1991 memorandum prepared by the Intermediary, this cost center’s functions were described as including the monitoring of tax legislation and working with industry groups to minimize cost to the Intermediary, as well as tax planning and administration. We questioned all costs claimed because the Intermediary did not segregate and eliminate from their claim the following explicitly unallowable functions: 1) those which influence tax legislation unallowable under FAR 31.205-22 and, 2) tax planning and administration functions which are unallowable under FAR 31.205-28, which allows only the cost of tax preparation and submission. Therefore, our finding and recommendation remain unchanged.

D. Pension

The Intermediary stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Intermediary did not provide any additional documentation to support that this decision had been changed.

Pension costs were not included in the scope of our audit. Therefore, we camot determine whether the additional pension costs discussed by the Intermediary are allowable, allocable, and reimbursable in accordance with the FAR and Medicare agreement. Therefore, our finding and recommendation remain unchanged.

UNALLOWABLE INDIRECT COSTS

The Intermediary claimed $38,321 of unallowable indirect costs for fiscal years 1990 through 1993. The unallowable costs resulted from the following:

- The Intermediary allocated $2,894 from a cost center which did not benefit the Medicare program. The Intermediary was unable to demonstrate how the costs incurred and allocated from the Actuarial Programs and Resources (111 -O 1-200) responsibility code provided a benefit to the Medicare program. This responsibility code is allocated to the Medicare program based on a factor of 2.91 percent. However, because this responsibility code provided no benefit to the Medicare program the allocated costs are unallowable in accordance with FAR 31.201-4, which states, in part:

  > "A cost is allocable if is assignable or chargeable to one or more cost objectives on the basis of relative benefits received... "

  In addition, the Medicare contract, Appendix B, Section XV, paragraph A.3., states:

  > "The following items are unallowable:.. .A... (3) costs relating to the contractor's underwriting activities, including related actuarial.. services... "

- The intermediary allocated $12,765 from responsibility codes which are unallowable in accordance with the FAR. Unallowable activities were performed in the Treasury Administration (1 12-04-100), Executive (121-01-000) and General Corporate (142-02-100) responsibility codes. Based on our inquiries, it was determined that personnel from these responsibility codes spent between 10 percent and 33 percent of their time on activities related to the selling of subsidiaries, merging and/or acquiring companies and raising capital. FAR 31. 205-27(a) states, in part:

> "... expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions, (2) . . change in the controlling interest in the ownership of a business, and (3) raising capital.. are unallowable. "

- The Intermediary claimed indirect costs based on budgeted cost allocations to the Medicare program which were not adjusted to actual costs. In fiscal years 1992 and 1993, the Intermediary changed the methodology for allocating Corporate and Staff (C&S) responsibility codes to the Medicare and other lines of business. Prior to fiscal year 1992, actual costs were allocated from these responsibility codes to the various lines of business. However, beginning in fiscal year 1992 the Intermediary began grouping these responsibility codes together and allocating the combined final budget amounts to the lines of business. We determined that the allocated amounts were not adjusted to actual costs. Instead any variance was charged directly to a corporate responsibility code which was not allocated to any lines of business. The use of budgeted cost allocations resulted in an overstatement of $19,986 of Medicare costs allocated from these cost centers. These costs are unallowable in accordance with FAR 31.201.

- The Intermediary was unable to provide supporting documentation to determine the allowability, allocability and reasonableness of $2,392 of costs allocated from the Executive responsibility code (121-01-000) for consulting services performed by a former officer. In addition, costs were allocated from this responsibility code for a special engagement performed by the Intermediary's independent public accounting firm which was unrelated to the annual financial statement audit and which did not appear to benefit the Medicare program, and services of an investment firm. Costs which do not benefit the Medicare program are unallowable in accordance with FAR 31.204. Costs associated with investment counseling do not benefit the Medicare program and are also unallowable in accordance with FAR 31.205-27(a).

- The Intermediary identified and segregated indirect responsibility codes which they determined were not allocable to Medicare in preparing the FACPS. However, the Intermediary was not consistent in eliminating MCEBO: IO (621-05-100) and United Way Campaign Expenses (721-02-000) from the FACP in each fiscal years 1991 and 1992 and claimed $284 associated with these responsibility codes. These responsibility codes are unallowable in accordance with FAR 31.201-4 because they do not benefit the Medicare program.

We summarized the unallowable indirect costs claimed as a result of these conditions as follows:

	FY 1990	FY 1991	FY 1992	FY 1993	TOTAL
Cost Centers Not Benefiting Medicare					
Actuarial Programs	$ 1,107	$ 579	$ 607	$ 601	$ 2,894
Claimed Costs Unallowed by FAR					
Treasury Administration	$ 485	$ 184	$ 484	$ 243	$ 1,396
Executive	1,755	1,625	3,398	3,030	9,808
General Corporate	360	339	460	402	1,561
Subtotal	$ 2,600	$ 2,148	$ 4,342	$ 3,675	$ 12,765
Budgeted Rather Than Actual Costs					
Various	$ 0	$ 0	$ 8,973	$ 11,013	$ 19,986
No Supporting Documentation					
Consulting Services	$ 0	$ 358	$ 639	$ 0	$ 997
Special Project	0	0	479	0	479
Investment Firm	0	0	916	0	916
Subtotal	$ 0	$ 358	$ 2,034	$ 0	$ 2,392
Overlooked Eliminating Cost Centers					
Center 621-05-100	$ 0	$ 0	$ 50	$ 15	$ 65
Center 721-02-000	0	146	73	0	219
Subtotal	$ 0	$ 146	$ 123	$ 15	$ 284
GRAND TOTAL	$ 3,707	$ 3,231	$ 16,079	$ 15,304	$ 38,321

Recommendation

We recommend that the Intermediary reduce the fiscal year 1990, 1991, 1992 and 1993 FACPS by their respective share of the $38,321 for unallowable indirect costs claimed. We also recommend that the Intermediary strengthen its internal control procedures to properly identify and segregate unallowable costs.

Intermediary 's Response

The Intermediary concurred with part of the findings and recommendations and disagreed with other parts. The Intermediary concurred with:

Topic	Amount
Actuarial Programs	$ 2,894
Treasury Administration	1,396
Executive	9,808
General Corporate	1,561
Use of Budgeted Costs	19,986
Consulting Services	997
Special Project	479
Investment Firm	916
Cost Center 621-05-100	65
Cost Center 721-02-000	219
Total	$ 38,321

However, the Intermediary disagreed with the remaining questioned costs: Subsidiary ($5 ,200) and Corporate Actuarial ($7,732).

Auditor's Additional Comments

We reviewed the Intermediary's response to the Subsidiary Audit and Corporate Actuarial findings in the draft report. Based on this review we determined that the allocation of 2.91 percent to Medicare appeared reasonable and allowable. We revised our finding and recommendation to reflect these costs as allowable.

ADDITIONAL INCENTIVE FEES

HCFA modified the Medicare Part A contract with the Intermediary for fiscal years 1992 and 1993 to provide for incentive payments if the Intermediary should incur costs less than established target costs per claim processed. The Intermediary received incentive payments in both years. Our review showed that the incentive payments received by the Intermediary were consistent with the administrative costs claimed by the Intermediary and the terms of the Medicare agreement. However, the results of our audit recommend the reduction of total allowable administrative costs which reduces the associated cost per claim processed. Therefore, based on our audit results, the Intermediary is entitled to additional incentive fees of $40,968 and $16,513 in fiscal years 1992 and 1993, respectively.

We did not review the basis for the established target costs. However, we recommend that HCFA consider the results of the audit and assure that unallowable costs are eliminated from the basis for future negotiated target costs as applicable.

Intermediary's Response

The Intermediary disagreed that the target costs were overstated. The Intermediary stated, in part:

> "... The process associated with negotiating a funding level for the upcoming fiscal year is separate from the process of negotiating a target cost for incentive purposes and two different branches within HCFA are responsible for responding to and settling on each proposal. The verbiage contained in the incentive contracts clearly documents the intent on the part of both HCFA and The Travelers to calculate incentive payments using the agreed upon target and audited, allowable costs . . . .
>
> In the case of the allowable costs discussed below that were submitted in revised Final Administrative Cost Proposals, we recalculated the associated incentive award and believe that the award should be recalculated again for purposes of issuing a closing agreement once the results of this most recent audit are finalized. "

Auditor's Additional Statement

We recalculated the additional incentive fees due to the Intermediary based on the questioned costs and the resulting lower cost per claim. The additional incentive fees were used to reduce the questioned costs in Exhibits 1 through 4.

OTHER MATTERS

In accordance with the Audit Guide, we reviewed and are separately reporting on the following issues considered to be Other Matters. These issues are discussed below.

FOLLOW-UP ON PRIOR AUDIT REPORT FINDINGS

The Intermediary implemented corrective actions relative to the findings and recommendations of the prior audit with which it agreed and submitted amended FACPS to HCFA. We were able to follow up on the nature and adequacy of the Intermediary's corrective actions. Specifically, we determined the Intermediary had excluded such costs from the FACPs for fiscal years 1990 through 1993.

However, the Intermediary disagreed with and is currently appealing four audit findings from the prior audit report. It has continued to claim these costs in the FACPs for fiscal years 1990 through 1993. See the Findings and Recommendations section of this report for further details on these costs.

Intermediary 's Response

See the response to Follow up of Prior Audit Findings in the Findings and Recommendations section of this report.

Auditor's Additional Comments

See the Auditor's Additional Comments to Follow up of Prior Audit Findings in the Findings and Recommendations section of this report.

INTERIM EXPENDITURE REPORT

We reviewed the Interim Expenditure Report (IER) for the month of September 1994, along with the methods and procedures for preparing this report. Our limited review disclosed that the IER contained unallowable and unallowable costs as discussed in the Findings and Recommendations section of this report. However, no additional weaknesses were disclosed in the preparation of the IER.

Intermediary's Response

None.

Auditor's Additional Statement

None.

COMPLEMENTARY INSURANCE CREDIT

The Intermediary was not involved with complementary insurance claims processing during our audit period.

Intermediary's Response

None.

Auditor's Additional Statement

None.

SIGNIFICANT ELECTRONIC DATA PROCESSING EXPENDITURES

The Intermediary did not incur significant electronic data processing (EDP) expenditures in fiscal years 1990 through 1993. The Intermediary made a significant change in the expenses processing system, however, no significant EDP expenses were incurred in comection with this change.

Intermediary 's Response

None.

Auditor's Additional Statement

None.

AREAS OF AUDIT CONCERN

HCFA officials had no other specific areas of concern to be addressed.

Intermediary 's Response

The Intermediary provided the following additional statements.

> ". . . submitted revised FACPs for FY 1990 . . . additional, allowable costs related to taxes, the qualified pension plan, EDP Corporate planning and a spreadsheet down load problem. . . .The costs related to the qualified pension plan are documented by the OIG in the audit reports:... HCFA indicated that we could not draw these additional funds until all cost items had been audited to verify their allowability . . . .
>
> . . the audit report does not reference these costs,...

Auditor's Additional Statement

The audit report included all costs on the revised FACPS filed on September 30, 1993. However, the scope of the audit did not include pension costs. Therefore, we did not review any costs either incurred or claimed for pensions nor did we comment specifically on the additional costs claimed in the revised FACPS. We recommend that HHS determine the allocability and allowability of the pension costs discussed above.

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INDEPENDENT AUDITOR'S REPORT

We have audited the Medicare Part A Final Administrative Cost Proposals of The Travelers Insurance Company (Travelers) for the period October 1, 1989 through September 30, 1993. These Final Administrative Cost Proposals are the responsibility of the Traveler's management. Our responsibility is to express an opinion on these Final Administrative Cost Proposals based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the *Government Auditing Standards (1988* Revision) published by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts in the Final Administrative Cost Proposals. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentations of the Final Administrative Cost Proposals. We believe that our audit provides a reasonable basis for our opinion.

The accompanying Final Administrative Cost Proposals were prepared to present the cost of administration allowable and applicable to Part A of the Health Insurance for the Aged and Disabled Program pursuant to the reimbursement principles of FAR Part 31, as interpreted and modified by the Medicare agreement. They are not intended to be a complete presentation of the company's assets, liabilities, revenue and expenses.

At the direction of the Department of Health and Human Services, we did not audit the pension costs claimed by Travelers on its Final Administration Cost Proposals. We determined, however, that Travelers had claimed unallowable pension contributions, facility and occupancy costs, tax planning costs, vacant space costs, equipment lease costs, and indirect costs.

In our opinion, except for the unallowable costs referred to in the preceding paragraph, and except for the effects on Exhibits 1 through 4 of such adjustments, if any, as might have been determined to be necessary had our scope not been limited to exclude pension costs, the accompanying Final Administrative Cost Proposals present fairly, in all material respects, the allowable administrative costs incurred under the Medicare agreement and recommended adjustments applicable to Part A of the Health Insurance for the Aged and Disabled Program from October 1, 1989 through September 30, 1993 in accordance with reimbursement principles of FAR Part 31, as interpreted and modified by the Medicare agreement, in conformity with generally accepted accounting principles.

This report is intended solely for the use described above and should not be used for any other purpose.

Tichenor & Associates

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 22, 1994

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

We have audited the Medicare Part A Final Administrative Cost Proposals of The Travelers Insurance Company (Travelers) for the period October 1, 1989 to September 30, 1993 and have issued our report thereon dated November 22, 1994.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards (1988* Revision) issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement.

In planning and performing our audit of the Final Administrative Cost Proposals of Travelers for the period October 1, 1989 through September 30, 1993 we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the Final Administrative Cost Proposals and not to provide assurance on the internal control structure.

The management of Travelers is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For purpose of this report, we have classified the significant internal control structure policies and procedures into the following categories:

- Procedures which assure accurate, current and complete disclosure of the financial results of the Medicare program in accordance with Federal reporting requirements;

- Procedures for determining the allowability and allocability of costs in accordance with the FAR Part 31 and Appendix B of the Medicare agreements;

- Cost allocation procedures which assure that indirect costs are accumulated by logical groupings, and distributed on the basis of the benefits accruing to the various cost objectives;

- Records that adequately identify the application of funds;

- Accounting records that are supported by source documentation;

- Effective control over and accountability for all funds, property, and other assets;

- Comparison of actual with budgeted amounts for each period.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize and report financial data consistent with the assertions of management in the Final Administrative Cost Proposals. A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the Final Administrative Cost Proposals being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we noted the following matters involving the internal control structure that we considered to be material weaknesses as defined above.

- Travelers does not have adequate quality assurance procedures for the payroll data being imputed into the Personnel Information Management System to assure that it has been approved by the responsible manager. The Internal Auditors have identified this weakness since 1991, however, no corrective actions have been designed and implemented.

- Travelers does not have adequate procedures for assuring that reimbursable travel costs are adequately documented in accordance with established corporate policies and procedures.

- Travelers does not periodically inventory assets such as furniture and equipment to assure their physical existence is reconciled to the recorded accountability for same.

- Travelers does not have adequate procedures to identify and segregate unallowable costs. As discussed in the Findings and Recommendations section of this report, Travelers charged Medicare unallowable direct and indirect costs. HHS requires that a system of internal control include procedures for reviewing all costs to determine whether costs are allowable and allocable.

- Time sheets were missing for several employees.

Recommendations:

We recommend that Travelers strengthen its internal control procedures to assure that:

1. Reimbursable travel costs are adequately documented and accounted for to assure compliance with corporate and Federal requirements.

2. Furniture and equipment records are properly maintained and verified and that assets are properly safeguarded.

3. Unallowable costs are identified, segregated and not included in the FACPS.

Intermediary's Response

The Intermediary agreed with all findings and recommendations except with the finding to strengthen and improve internal controls over the periodic inventory and reconciliation of same. The Intermediary has designed and implemented procedures to address the identified weaknesses, except that the Intermediary believes the alternative procedures in place for inventory are adequate. The Intermediary's response is included as an Appendix.

Auditor's Additional Comments

We reviewed the alternative control procedures as described by the Intermediary. The procedures do not include a systematic, company wide periodic inventory of all assets providing for the comparison of recorded accountability to actual physical existence by individuals that are independent of both custodial and record keeping functions. Therefore, our finding and recommendation remain unchanged.

In our opinion, except for the conditions described above, Travelers' internal controls were adequate for HHS purposes for the period October 1, 1989 to September 30, 1993.

This report is intended for the information of the Department of Health and Human Services and Travelers' management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Tichenor & Associates

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 22, 1994

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE

We have audited the Medicare Part A Final Administrative Cost Proposals of The Travelers Insurance Company (Travelers) for the period October 1, 1989 through September 30, 1993 for its Medicare Part A agreement with HCFA and have issued our report thereon dated November 22, 1994.

We conducted our audit in accordance with generally accepted auditing standards and Government *Auditing Standards (1988* Revision) issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement.

Compliance with laws and regulations applicable to Travelers is the responsibility of their management. As part of obtaining reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement, we performed tests of the Intermediary's compliance with certain provisions of laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in statutes and regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the Final Administrative Cost Proposals. The results of our tests of compliance did not disclose any material instances of noncompliance.

We considered Traveler's compliance with applicable laws and regulations in forming our opinion on whether the Final Administrative Cost Proposals are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated November 22, 1994 on those Final Administrative Cost Proposals.

Except for the unallowable costs charged to the Medicare program as described in the Findings and Recommendations section of this report, the results of our tests of compliance indicated that, with respect to the items tested, Travelers had complied, in all material respects, with the

provisions referred to in the third paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that Travelers had not complied, in all material respects, with those provisions.

This report is intended for the information of the Department of Health and Human Services and the Travelers' management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Tichenor & Associates

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 22, 1994

FINAL ADMINISTRATIVE COST PROPOSALS

Exhibit 1

THE TRAVELERS INSURANCE COMPANY

Final Administrative Cost Proposal

For the Period October 1, 1989 through September 30, 1990

Operation	Costs Claimed	Increase (Decrease) Recommended Adjustments	Footnote Reference
Bills Payment	$ 1,393,867	$	
Reconsiderations and Hearings	217,438		
Medicare Secondary Payer	530,077		
Medical Review and Utilization Review	480,134		
Provider Desk Reviews	753,658		
Provider Field Audits	546,945		
Provider Settlements	534,142		
Provider Reimbursements	657,065		
Productivity Investments	299,911		
Other	4,561		
Costs Not Associated With An Operation		(116,840)	(1)
TOTAL	$ 5,417,798	$ (116,840)	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

Exhibit 2

THE TRAVELERS INSURANCE COMPANY

Final Administrative Cost Proposal

For the Period October 1, 1990 through September 30, 1991

Operation	Costs Claimed	Increase (Decrease) Recommended Adjustments	Footnote Reference
Bills Payment	$ 1,330,378	$	
Reconsiderations and Hearings	239,835		
Medicare Secondary Payer	380,868		
Medical Review and Utilization Review	349,062		
Provider Desk Reviews	799,100		
Provider Field Audits	513,771		
Provider Settlements	295,091		
Provider Reimbursements	670,785		
Productivity Investments	204,719		
Other	0		
Costs Not Associated With An Operation		64,260	(1)
TOTAL	$ 4,783,609	$ 64,260	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

Exhibit 3

THE TRAVELERS INSURANCE COMPANY

Final Administrative Cost Proposal

For the Period October 1, 1991 through September 30, 1992

Operation	Costs Claimed	Increase (Decrease) Recommended Adjustments	Footnote Reference
Bills Payment	$ 1,466,290	$	
Reconsiderations and Hearings	239,068		
Medicare Secondary Payer	258,160		
Medical Review and Utilization Review	381,522		
Provider Desk Reviews	915,064		
Provider Field Audits	354,937		
Provider Settlements	394,520		
Provider Reimbursements	607,281		
Productivity Investments	200,400		
Other	121,786		
Costs Not Associated With An Operation		(92,907)	(1)
TOTAL	$ 4,939,028	$ (92,907)	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

Exhibit 4

THE TRAVELERS INSURANCE COMPANY

Final Administrative Cost Proposal

For the Period October 1, 1992 through September 30, 1993

Operation	Costs Claimed	Increase (Decrease) Recommended Adjustments	Footnote Reference
Bills Payment	$ 1,432,306	$	
Reconsiderations and Hearings	240,999		
Medicare Secondary Payer	289,804		
Medical Review and Utilization Review	323,868		
Provider Desk Reviews	970,029		
Provider Field Audits	362,289		
Provider Settlements	280,271		
Provider Reimbursements	647,450		
Productivity Investments	159,551		
Other	299,510		
Costs Not Associated With An Operation		(17,169)	(1)
TOTAL	$ 5,006,077	$ (17,169)	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

APPENDIX

INTERMEDIARY'S WRITTEN RESPONSE

TO

FINDINGS AND RECOMMENDATIONS

SEE APPENDIX FOLLOWING

RAILROAD RETIREMENT BOARD REPORT

1

REPORT ON

AUDIT OF ADMINISTRATIVE COSTS INCURRED UNDER

PART B OF THE MEDICARE PROGRAM

FOR THE PERIOD

OCTOBER 1, 1989 THROUGH SEPTEMBER 30, 1993

BY

THE TRAVELERS INSURANCE COMPANY

HARTFORD, CONNECTICUT

NOTICE

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of Tichenor & Associates, Certified Public Accountants, as concurred in by the HHS OIG Office of Audit Services. Final determinations on these matters will be made by authorized HHS operating division officials.

CONTRACT DISCLOSURE STATEMENT

This report is made pursuant to Contract HHS-100-91 -0030 with Tichenor & Associates, Certified Public Accountants, 12531 Clipper Drive, Suite 202, Woodbridge, Virginia, 22192. Certain information contained herein is subject to disclosure under the Freedom of Information Act, 5 U.S.C. 522 (b)4). The Task Monitor was Mr. Robert Champagne, HHS Office of inspector General, Room 515, 450 Main Street, Hartford, Connecticut, *06103*.

The names of the persons employed by Tichenor & Associates, with managerial or professional responsibility for such work, or for the content of the report, are as follows:

Jonathan Crowder, CPA
Deirdra McKenna, CPA
Edward Noble, CPA
Kenneth Wachner, Sr. Auditor

SUMMARY

The Travelers Insurance Company (the Carrier) claimed administrative costs totaling $175,963,103 on its Medicare Part B Final Administrative Cost Proposals (FACPs) for fiscal years ended September 30, 1990, 1991, 1992, and 1993. Our recommended audit adjustments reduce the claimed costs by $2,408,357 and add incentive payments of $805,801 due to the Carrier based on the audit adjustments. The audit findings are summarized as follows:

- The Carrier claimed $791,086 of facilities and occupancy costs for space in excess of 135 net-usable square feet per equivalent man-year as allowed by the contract. The Carrier allocated facility and occupancy costs based on budgeted rates rather than actual rates.

- The Carrier claimed current costs of $1,311,523 for indirect costs which were identified as unallowable during prior audits of Medicare administrative costs. Claiming costs which were previously identified as unallowable is unallowable in accordance with the Medicare agreement, Article XIII, paragraph L. These unallowable indirect costs included $822,920 for certain leased equipment which is unallowable in accordance with FAR 31.201-4; $386,553 for vacant space which is unallowable in accordance with FAR 31.205-17; $21,656 for tax planning costs which is unallowable in accordance with FAR 3 1.205-41(b)(l) and 31.205-27(a); and, $80,394 for pension contributions which are unallowable in accordance with FAR 3 1.205-6(j)(2)(ii) and Cost Accounting Standards (CAS) 412.40.

- The Carrier claimed $316,417 in unallowable indirect costs including (1) cost centers that do not benefit Medicare, (2) costs not incurred, (3) unsupported costs, (4) unallowable costs, and (5) cost centers inconsistently allocated.

- The Carrier understated the return on investment in fiscal year 1990 applicable to Medicare by $10,669. Return on investment is allowable in accordance with FAR 31.205-10 and the Medicare agreement, Appendix B, Section X. A..

- The Carrier was entitled to and received an incentive fee in fiscal years 1992 and 1993. However, the incentive fee paid was based on the administrative costs per claim as calculated by the Carrier. This claimed per unit cost included unallowable administrative costs as summarized above. Reducing the administrative costs by the above questioned costs resulted in a lower per unit cost and therefore an additional incentive fees of $805,801.

We evaluated the Carrier's system of significant internal accounting and administrative controls and its compliance with laws and regulations that can materially affect the Carrier's FACPs. Our evaluation, in addition to the above recommended adjustments, disclosed internal control weaknesses in the inventory control and travel expense systems; however, we identified no specific financial impact. Otherwise, we believe control procedures were generally adequate for the Department of Health and Human Services' (HHS) purposes, and that the Carrier complied with the terms and provisions of laws and regulations for the transactions tested. Tichenor & Associates' reports on its reviews of internal control and on compliance appear on pages 23 and 27, respectively.

We held a departure conference with Carrier representatives on November 22, 1994, the date we concluded our fieldwork. The Carrier was provided with a copy of the draft audit report, to which they provided written comments. We incorporated those comments into the final report. The Carrier concurred with a portion of the total questioned costs such as unallowable indirect costs, understated facility and occupancy costs, and understated return on investment. The Carrier, however, disagreed with the remaining cost findings and recommendations. The Carrier also concurred with all of our internal control findings and recommendations except for periodic inventories of assets with which they did not agree. The Carrier's response is included as an Appendix to this report.

TABLE OF CONTENTS

PAGE

SUMMARY i

INTRODUCTION 1
Background 1
Regulations Relating to Cost Reimbursement 2
Scope of Audit 3

FINDINGS AND RECOMMENDATIONS 4
Unallowable Facility and Occupancy Costs 4
Follow Up ofPrior Audit Findings 6
Unallowable Indirect Costs... 13
Understated RetumonInvestment 16
Additional Incentive Payments 17

OTHER MATTERS 18
Follow-Up On Prior Audit Report Findings 18
Interim Expenditure Report 18
Complementary Insurance Credit... 19
Significant Electronic Data Processing Expenditures 19
Areas of Audit Concer n...... 20

INDEPENDENT AUDITOR'S REPORT 21

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL 23

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE 27

FINAL ADMINISTRATIVE COST PROPOSALS 29
Exhibit l- Fiscal Year 1990..... 30
Exhibit 2- Fiscal Year 1991..... 31
Exhibit 3- Fiscal Year 1992..... 32
Exhibit 4- Fiscal Year 1993 33

APPENDIX - Carrier's Written Response to Findings and Recommendations . . . 34

INTRODUCTION

The information contained in this report relates to an audit of administrative costs incurred under Title XVIII, Part B, of the Social Security Act by The Travelers Insurance Company (the Carrier) during the four-year period October 1, 1989 through September 30, 1993.

BACKGROUND

Health Insurance for the Aged and Disabled (Medicare), Title XVIII of the Social Security Act, provides a hospital insurance program and a related medical insurance program for (a) eligible persons aged 65 and over; (b) disabled persons under 65 who are entitled to Social Security or Railroad Retirement disability benefits for at least 24 consecutive months; and (c) individuals under 65 with chronic kidney disease who are currently insured by or entitled to Social Security benefits.

The medical insurance program, Part B, Supplementary Insurance Benefits for the Aged and Disabled, is a voluntary program and provides protection against the costs of physician's services, hospital outpatient services, home health care services and other health services. The Medicare program is administered by the Health Care Financing Administration (HCFA). Title XVIII provides, however, that public or private organizations, known as Carriers (Part B), may assist in administering the Medicare program under contracts or agreements with HCFA for processing bills and making payments that are due under the program.

Carriers are reimbursed for all reasonable and allowable costs incurred in administering the programs, except for specific limitations that may be agreed to in the individual Medicare contracts and agreements. During the four-year period covered by our audit, the Carrier served as the carrier in administering Medicare Part B claims in four (4) states: Comecticut, Minnesota, Mississippi and Virginia.

During the audit period, October 1, 1989 through September 30, 1993, the Carrier processed more than 98 million claims, paid Medicare Part B benefits totaling over $5.6 billion and claimed administrative costs of $175.9 million for this period as follows:

Period	Claimed costs	Claims Processed
10/1/89 - 9/30/90	$ 40,690,561	21,036,169
10/1/90 - 9/30/91	42,440,867	23,401,163
10/1/91 - 9/30/92	44,920,191	26,120,595
10/1/92 - 9/30/93	47,911,484	27,511,918
TOTAL	$ 175,963,103	98,069,845

Costs incurred in connection with the Carrier's activities are accumulated in cost centers which are subsequently allocated to its various lines of business, including its Medicare Part B lineof business.

REGULATIONS RELATINGTOCOST REIMBURSEMENT

Article XV of the Medicare agreement states that allowable costs under the agreement shall be determined in accordance with theprovisions of Part31 of the Federal Acquisition Regulation (FAR) as interpreted and modified by Appendix B to the agreement. Section 31.201-1 of the FAR provides that the total cost of a contract is the sum of the allowable direct and indirect costs allocable to a contract, incurred or to be incurred, less any applicable credits.

FAR Part 31 also provides that items of cost are allowable charges provided that the tests of reasonableness and allocability are met and that generally accepted accounting principles are followed. A reasonable cost is defined as one that would be incurred by an ordinarily prudent person in the conduct of competitive business. Further, a cost is allocable if it is assigned or chargeable to a particular cost objective in reasonable proportion to the benefits received.

Sections 31.202 and 31.203 of the FAR define direct and indirect costs as follows:

> Direct Costs: Any cost that can be identified specifically with a particular cost objective. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly thereto. Costs identified specifically with other work of the Carrier are direct costs of that work and are not to be charged to the contract directly or indirectly.
>
> Indirect Costs: Any cost that, because of its incurrence for common or joint objectives, is not readily subject to treatment as a direct cost.

Finally, Section 31.205 of the FAR provides detailed guidelines as to whether or under what circumstances specific types of costs are allowable or unallowable.

SCOPE OF AUDIT

We audited the Medicare Part B Final Administrative Cost Proposals (FACPs) of The Travelers Insurance Company (the Carrier) for the period October 1, 1989 through September 30, 1993. The FACPS are the responsibility the Carrier's management. Our responsibility is to express an opinion on these FACPs based on our audit.

Our examination was made in accordance with generally accepted auditing standards and with the *Government Auditing Standards (1994* Revision) issued by the Comptroller General of the United States. The primary purpose of the examination was to express an opinion as to whether the Carrier's FACPS present fairly the allowable costs of administration in conformity with the reimbursement principles contained in Part 31 of the FAR as interpreted and modified by the Medicare agreement. The examination included an evaluation of the accounting system and related internal controls, tests of the accounting records, and the application of the auditing procedures contained in the *Audit Guide for the Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers Under Title XVIII of the Social Security Act* (Audit Guide) issued by the Department of Health and Human Services Office of Inspector General in March, 1991. However, at the direction of the Department of Health and Human Services (HHS), Office of Inspector General (OIG), we did not audit the Carrier's pension plans.

The audit fieldwork was conducted at The Travelers Insurance Company, Hartford, Connecticut, during the period August 15, 1994 through November 22, 1994.

This report is intended solely for the purpose described above and should not be used for any other purpose.

FINDINGS AND RECOMMENDATIONS

For the period October 1, 1989 through September 30, 1993, the Carrier claimed administrative costs totaling $175,963,103 on its Medicare Part B FACPS. Our audit disclosed questioned costs of $1,602,556 as unallowable costs in accordance with applicable Federal regulations and the terms and conditions of the Medicare agreement as follows.

Summary of Claimed and Questioned Costs 10/1/89 through 9/30/93			
Period	Claimed costs	Questioned costs	Reference
10/1/89 - 9/30190	$ 40,690,561	$ 823,427	Exhibit 1
10/1/90 - 9/30/91	42,440,867	(27,471)	Exhibit 2
10/1/91 - 9/30/92	44,920,191	623,774	Exhibit 3
10/1/92 - 9/30/93	47,911,484	182,826	Exhibit 4
TOTAL	$ 175,963,103	$ 1,602,556	

Our detailed findings and recommendations are also discussed below.

UNALLOWABLE FACILITY AND OCCUPANCY COSTS

The Carrier claimed $791,086 of facility and occupancy (F&O) costs for space exceeding 135 net-usable square feet per equivalent man-year. The allocation of space in excess of 135 net-usable square feet per equivalent man- year is unallowable in accordance with Appendix B, Section X.B. 1., to the Medicare contract, which states:

> "With respect to space, either leased or owned, acquired after the effective date of this agreement/contract, the guideline for the amount of such space which may hereafter be allocated for the performance functions under this agreement/contract to the Medicare program, without justification by the contractor, shall be an average of 135 square feet of net usable space per equivalent man-year. Additional amounts of space may be allocated, provided that the contractor justifies such additional amounts. "

We determined that the Carrier has not submitted a request to HCFA justifying the allocation of greater than 135 net-usable square feet per equivalent man-year to the Medicare program. We also determined that the Carrier had allocated indirect facility costs based on budgeted average costs per square foot which were not adjusted to actual. We determined that budgeted and actual indirect facility costs per square foot were as follow:

Fiscal Year	Budgeted/Claimed Rate	Actual Rate
1990	$24.14	$25.09
1991	$24.44	$25.04
1992	$21.45	$21.75
1993	$21.26	$22.32

The use of budgeted rates versus actual rates resulted in an understatement of the indirect facility costs. Therefore, we calculated the total actual F&O costs using the actual rates shown above. We then calculated the unallowable F&O costs by determining the excess square feet allocated to Medicare and multiplying it by the average cost per square foot for the Carrier's home offices. The results of the calculations were netted together to determine the total unallowable costs. Our audit disclosed unallowable facility and occupancy costs of $791,086, as follows:

Fiscal Year	Total F&O costs	Total Sq. Ft. Allocated	Excess Sq. Ft.	Questioned costs
1990	$3,334,650	145	10	$ 153,435
1991	3,522,860	141	6	86,338
1992	3,913,713	155	20	395,556
1993	3,531,549	146	11	155,757
TOTAL	$14,302,772			$ 791,086

Recommendation

We recommend that the Carrier reduce the fiscal year 1990, 1991, 1992 and 1993 FACPS by their respective share of the $791,086 for unallowable facility and occupancy costs claimed.

Carrier's Response

The Carrier summarized their position as follows:

> "This audit finding is comprised of two issues: the use of budgeted versus actual rates which caused costs to be understated . . . and excess square footage. The net amount . . . was questioned in the audit reports.

> We agree with the audit finding relative to the use of budgeted versus actual rates which resulted in an understatement of costs for the four fiscal years . . . .
>
> We disagree with the second component of the finding that recommends disallowance of net usable square feet in excess of the contractual 135 square feet on the basis that the Government is estopped from retroactively requiring Travelers to include corporate home office space in the calculation of net usable square feet. In addition to that argument, we have also included justification for the additional post- 1978 space and maintain that space acquired prior to 1978 should have been excluded from the auditor's calculation but was not . ..."

<u>Auditor's Additional Comments</u>

Although the Carrier stated that the Government has previously not required the inclusion of corporate home office space in the calculation of total facility and occupancy costs subject to the 135 square foot limitation, we have determined that the facility and occupancy finding developed in a prior audit of fiscal years 1984 and 1985, were consistent with our basis. Furthermore, our findings were developed in accordance with Appendix B to the Medicare agreement. The final determination as to the allowability of the questioned facility and occupancy costs is a legal matter which is outside of the scope of our audit. Therefore, we continue to include the applicable corporate home office space in the calculation of net usable square feet. We concur that space that was acquired, and not modified through lease amendment, prior to October 1978 should not be included in the calculation of net usable square feet and the personnel residing in that space should not be included in the calculation of the net equivalent man years. The Carrier provided additional data to support the calculation of these items. We considered and evaluated this information in determining the revised allowable and unallowable costs.

FOLLOW UP OF PRIOR AUDIT FINDINGS

The Carrier claimed $1,311,523 for indirect costs which were identified as unallowable during prior audits of Medicare administrative costs. The fiscal year 1988-1989 audit questioned costs claimed for allocated vacant space, tax planning costs, leased equipment costs and pension contributions. These findings were sustained by HCFA as documented in the Audit Clearance Document dated December 16, 1991. However, the Carrier did not concur with the finding or determination and, according to HHS OIG, has appealed the decision.

The Medicare contract, Article XIII, paragraph L., states:

> "If the Secretary and the Carrier are unable to agree upon a final amount of the administrative costs of the Intermediary for a particular period, the Secretary shall issue a final determination of the amount of such administrative costs for such period and inform the Intermediary of such costs, with a full explanation of the exceptions he has taken to the Intermediary's report of its allowable costs. If a

dispute arises as to the exceptions taken by the Secretary, the Intermediary may appeal the final determination in accordance with the provisions of Article XXI of this agreement.... Where a particular cost or type of cost is disallowed by final determination of the Secretary and the Intermediary is not in agreement with the Secretary's disallowance, the Intermediary will, for subsequent claims, abide by the decision of the Secretary and agrees not to be reimbursed, pending resolution of any amounts of such costs. Until the issue is resolved, the Intermediary will segregate such costs from all others, and specify the amounts of such costs on all subsequent claims. " (Emphasis added)

Therefore, these costs should have been specifically identified by the Carrier as not reimbursable pending the outcome of the appeal process. The unallowable costs were identified as follows:

Cost Category	1990	1991	1992	1993	Total	Note
Vacant Space	$ 119,185	$ 87,130	$ 88,989	$ 91,249	$ 386,553	(1)
Leased Equipment	232,120	276,174	194,413	120,213	822,920	(2)
Tax Planning	5,263	4,652	6,074	5,667	21,656	(3)
Pension Contributions	304,231	(508,433)	426,070	(141,474)	80,394	(4)
TOTAL	$ 660,799	$ (140,477)	$ 715,546	$ 75,655	$ 1,311,523	

Note:

(1) Vacant Space

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Carrier allocated costs to the Medicare program for vacant space. We determined that the Carrier claimed $386,553 for vacant space in fiscal years 1990 through 1993. The allocation of idle facilities and idle capacity costs to the Medicare contract are unallowable in accordance with FAR 31.205-17 which states:

"The costs of idle facilities are unallowable... "

Therefore, we continue to classify the costs claimed for vacant space as unallowable under the current Medicare program.

(2) Leased Equipment

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Carrier allocated costs to the Medicare program for leased equipment which did not benefit the Medicare program. We determined that the Carrier claimed $822,920 for leased equipment which they could not demonstrate benefitted the Medicare contract in fiscal years 1990 through 1993. The allocation of costs to the Medicare contract is unallowable in accordance with FAR 31.201-4 if no benefit is received by the program.

Therefore, we continue to classify the costs claimed for leased equipment which does not benefit the Medicare program as unallowable under the current Medicare program.

(3) Tax Planning

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Carrier allocated costs to the Medicare program from responsibility code 115-04-100 Tax Planning. We determined that the Carrier claimed $21,656 for the tax planning cost center in fiscal years 1990 through 1993. This cost center is responsible for Federal, State and foreign tax planning, development of tax policies relating to tax laws, and the acquisition of companies or business segments. FAR 31.205-41(b)(l) states:

> "The following types of costs are not allowable: (1) Federal income and excess profit taxes. "

Also, FAR 31.205-27(a) states, in part:

> " . . . expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business including mergers and acquisitions... are unallowable. "

Therefore, we continue to classify the costs claimed for the Tax Planning responsibility code as unallowable under the current Medicare program.

(4) Pension Contributions

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Carrier claimed costs under the Medicare program for unfunded nonqualified pension contributions. We did not perform a review of the pension costs claimed by the Carrier. However, during our review of the prior audit findings and our determination of their disposition, we determined that the Carrier had continued to claim unallowable pension costs as reported in the prior audit. The Carrier provided the amount, by fiscal year, which had been claimed but was unallowable for fiscal years 1990 to 1993. These amounts included credits for fiscal year 1991 and 1993.

The Carrier stated that the credits are due to timing differences created due to the reporting period, calendar year versus fiscal year, and the funding of an unqualified pension plan which is adjusted on a calendar basis and may include credits from prior periods. We did not determine whether the amounts provided by the Carrier were supported by the accounting records since pension costs had been excluded from the scope of our audit. However, we recommend that HCFA verify that the amounts, including the credits, are accurate.

The Carrier claimed $80,394 for the same unqualified pension contributions in fiscal years 1990 through 1993. FAR 3 1.205-6(j)(2)(ii) does not allow costs of pension plans that are discriminatory to the Federal Government. Medicare is the only line of business currently funding its entire share of the pension plan. The costs of the plan for other lines of business are accrued but not funded until benefits are due to participants. This practice is discriminatory to the Federal Government. In addition, the Cost Accounting Standards (CAS) 412.40 (c) do not allow the cost of pension plans if the payment of benefits from the plan cannot be compelled by the participants. The Carrier could not clearly illustrate that the benefits under the nonqualified plan can be legally compelled. The unallowable costs are the difference between the excess pension costs claimed over the pension costs funded.

Recommendation

We recommend that the Carrier reduce the fiscal year 1990, 1991, 1992 and 1993 FACPS by their respective share of the $1,311,523 for unallowable costs which continue to be claimed although they have been identified as unallowable in prior audits.

Carrier's Response

The Carrier disagreed with the finding and recommendation. The Carrier stated, in part:

> "...These issues were under dispute from the audit of fiscal years 1988 and 1989 . . . these costs were not audited during the current audit. We were requested to quantify the costs that were claimed during the four fiscal years and were informed that Tichenor & Associates could not render an opinion as to the allowability of these costs, but that these cost issues would be decided based on the resolution of the fiscal years 1988 and 1989 dispute.
>
> We recently reached a tentative settlement with HCFA on these four issues and propose that these costs in fiscal years 1990 through 1993 be resolved similarly. We support the decision made by HCFA related to the allowability of these costs. Each of the four items is addressed below:
>
> **A. Vacant Space**
>
> These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. Our reasoning is restated below:...

. . . the FAR permits the allowability of idle facilities costs when they are necessary to meet fluctuations in workload, or when they were necessary when acquired and are now idle because of reasonably unforeseen changes in requirements . . . .

Travelers vacant space costs are allowable under these express cost allowability principles. The Travelers vacant space policy[1] is that rent is charged to the Vacant Space cost center when a "tenant" (a Travelers Department or unit) moves out of an area as a result of a Corporate directive and in accord with the Master Space Plan (MSP). . . . The vacant space cost center is also used when tenants are moved to temporary space while their permanent location is renovated. The tenant is charged for the temporary space while the area under renovation is charged to vacant space. Thus, Travelers vacant space involves both idle capacity as well as idle facilities.

As can be seen from Travelers' vacant space policy, the vacant space charges relating to idle facilities arise from changed requirements, reorganization changes, production economies, and other causes, all of which factors Travelers takes into consideration under its MSP in assigning space. In addition, the vacant space charges arising from idle capacity are clearly the result of normal business fluctuations, not subject to reduction or elimination, such as when space is being renovated.

B. Lease Equipment

These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. Our reasoning is restated below:...

. . . in mid-1988, Travelers chose to lease, rather than purchase, its ADP equipment needs. This option offered Travelers certain financial advantages.

When Travelers made lease payments to the lessor, Travelers booked the amortized equipment amount to the responsibility code which "manages" the equipment repayment. The costs are built into the charge rates of the Data Center, and are allocated to Medicare based on the usage of the DP cost centers. . . .Thus, Medicare bore its proportional share of an allowable and necessary business expense.

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[1]Travelers set forth this policy and additional explanation on these costs in its May 30th, 1991 response to the draft audit report.

C. Tax Planning

These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. Our reasoning is restated below:...

. . . the Tax Plaming Center is occasionally involved in analyzing the tax consequences of the proposed acquisition or disposition of various business segments or subsidiaries, its role does not extend to the "planning or execution of the organization or reorganization" of a business as described in FAR $31.205-27....

Second,...The costs of preparing and submitting business tax forms are expressly allowable under FAR $31.205 -28,....

. . .Thus, the Tax Planning Center costs associated with filing Federal Income tax forms are expressly allowable costs under FAR $31.205-28.

D. Pension Contributions

We propose settling on the unqualified plan using the same methodology that was used to settle this issue for fiscal years 1988 and 1989. Ron Solomon, HCFA, OACT, in his memo dated April 28, 1994, recommended that, "Since ultimate payment of accrued, but not projected, benefits is secured by the amendments, the government will consider accrual costs for the value of only the accrued benefits as allocable and allowable contract costs without regard to funding. This recommendation is to apply to costs for all years begiming with fiscal year 1987, notwithstanding the fact that the FAR change was not effective until fiscal year 1990. "

For the four fiscal years, we claimed a total of $48,682 on our FACPS. The revaluation by our actuaries indicates that the total allowable cost for the period was $771,929. Therefore, we understated our costs by $723,247 for FY 90 through 91. These additional costs should be considered as part of the settlement for these years. (Parts A, B, and RRB)

Auditor's Additional Comments

A. Vacant Space

The Carrier stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Carrier did not provide any additional documentation to support that this decision had been changed.

In addition, the Carrier provided their Master Space-Plan policy stating that the only facility costs incurred for vacant space are those associated with changed requirements, reorganization changes, production economies and other causes which should be interpreted as allowable under FAR 31.205-17. However, we are aware of downsizing actions taken by the Carrier as a result of corporate reorganizations planned, pending, or initiated, which result in permanent reductions and vacant space which is unallowable idle facility costs. Therefore, our finding and recommendation remain unchanged.

B. Leased Equipment

The Carrier stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Carrier did not provide any additional documentation to support that this decision had been changed.

The Carrier did not address the allocability of the costs based on benefit, nor did they address how the leased equipment directly benefitted the Medicare program. Therefore, our finding and recommendation remain unchanged.

C. Tax **Planning**

The Carrier stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Carrier did not provide any additional documentation to support that this decision had been changed.

In a January 4, 1991 memorandum prepared by the Carrier, this cost center's functions were described as including the monitoring of tax legislation and working with industry groups to minimize cost to the Carrier, as well as tax planning and administration. We questioned all costs claimed because the Carrier did not segregate and eliminate from their claim the following explicitly unallowable functions: 1) those which influence tax legislation unallowable under FAR 31.205-22 and, 2) tax planning and administration functions which are unallowable under FAR 31.205-28, which allows only the cost of tax preparation and submission. Therefore, our finding and recommendation remain unchanged.

D. Pension

The Carrier stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Carrier did not provide any additional documentation to support that this decision had been changed.

Pension costs were not included in the scope of our audit. Therefore, we cannot determine whether the additional pension costs discussed by the Carrier are allowable, allocable, and reimbursable in accordance with the FAR and Medicare agreement. Therefore, our finding and recommendation remain unchanged.

UNALLOWABLE INDIRECT COSTS

The Carrier claimed $316,417 of unallowable indirect costs for fiscal years 1990 through 1993. The unallowable costs resulted from the following:

- The Carrier allocated $19,264 from a cost center which did not benefit the Medicare program. The Carrier was unable to demonstrate how the costs incurred and allocated from the Actuarial Programs and Resources (1 11-01-200) responsibility code provided a benefit to the Medicare program. The responsibility code is allocated to the Medicare program based on a factor of 2.91 percent. However, because this responsibility code provided no benefit to the Medicare program the allocated costs are unallowable in accordance with FAR 31.201-4, which states, in part:

    > "A cost is allocable if is assignable or chargeable to one or more cost objectives on the basis of relative benefits received... "

    In addition, the Medicare contract, Appendix B, Section XV, paragraph A. 3., states:

    > "The following items are unallowable:.. .A... (3) costs relating to the contractor's underwriting activities, including related actuarial . . . services... "

- The Carrier allocated $101,831 from responsibility codes which are unallowable in accordance with the FAR. Unallowable activities were performed in the Treasury Administration (1 12-04-100), Executive (121-01-000) and General Corporate (142-02-100) responsibility codes. Based on our inquiries, it was determined that personnel from these responsibility codes spent between 10 percent and 33 percent of their time on activities related to the selling of subsidiaries, merging and/or acquiring companies and raising capital. FAR 31.205-27(a) states, in part:

    > ". . . expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions, (2) change in the controlling interest in the ownership of a business, and (3) raising capital . . . are unallowable. "

- The Carrier claimed indirect costs based on budgeted cost allocations to the Medicare program which were not adjusted to actual costs. In fiscal years 1992 and 1993, the Carrier changed the methodology for allocating Corporate and Staff (C&S) responsibility codes to the Medicare and other lines of business. Prior to fiscal year 1992, actual costs were allocated from these responsibility codes to the various lines of business. However, beginning in fiscal year 1992 the Carrier began grouping these responsibility codes together and allocating the combined final budget amounts to the lines of business. We determined that the allocated amounts were not adjusted to actual costs. Instead any variance was charged directly to a corporate responsibility code which was not allocated to any lines of business. The use of budgeted cost allocations resulted in an overstatement of $172,360 of Medicare costs allocated from these cost centers. These costs are unallowable in accordance with FAR 31.201.

- The Carrier was unable to provide supporting documentation to determine the allowability, allocability and reasonableness of $20,398 of costs allocated from the Executive responsibility code (121-01-000) for consulting services performed by a former officer. In addition, costs were allocated from this responsibility code for a special engagement performed by the Carrier's independent public accounting firm which was unrelated to the annual financial statement audit and which did not appear to benefit the Medicare program, and services of an investment firm. Costs which do not benefit the Medicare program are unallowable in accordance with FAR 31.204. Costs associated with investment counseling do not benefit the Medicare program and are also unallowable in accordance with FAR 31.205-27(a).

- The Carrier identified and segregated indirect responsibility codes which they determined were not allocable to Medicare in preparing the FACPS. However, the Carrier was not consistent in eliminating MCEBO: IO (621-05-100) and United Way Campaign Expenses (721-02-000) from the FACP in fiscal years 1991, 1992 and 19932 and claimed $2,564 associated with these responsibility codes. These responsibility codes are unallowable in accordance with FAR 31.201-4 because they do not benefit the Medicare program.

We summarized the unallowable indirect costs claimed as a result of these conditions as follows:

	FY 1990	FY 1991	FY 1992	FY 1993	TOTAL
Cost Centers Not Benefiting Medicare					
Actuarial Programs	$ 5,928	$ 3,135	$ 5,123	$ 5,078	$ 19,264
Claimed Costs Unallowed by FAR					
Treasury Administration	$ 2,567	$ 1,644	$ 4,091	$ 2,056	$ 10,358
Executive	9,366	14,196	28,693	25,592	77,847
General Corporate	2,001	3,135	3,692	4,798	13,626
Subtotal	$ 13,934	$ 18,975	$ 36,476	$ 32,446	$ 101,831

	FY 1990	FY 1991	FY 1992	FY 1993	TOTAL
Budgeted Rather Than Actual Costs					
Various	$ 0	$ 0	$ 75,768	$ 96,592	$ 172,360
No Supporting Documentation					
Consulting Services	$ 0	$ 3,127	$ 5,487	$ 0	$ 8,614
Special project	0	0	4,046	0	4,046
Investment Firm	0	0	7,738	0	7,738
Subtotal	**$ 0**	**$ 3,127**	**$ 17,271**		-
Overlooked Eliminating Cost Centers					
Center 621-05-100	$ 0	$ 0	$ 396	$ 123	$ 519
Center 721-02-000	0	1,431	614	0	2,045
Subtotal	$ 0	$ 1,431	$ 1,010	$ 123	$ **2,564**
GRAND TOTAL	**$ 19,862**	**$ 26,668**	**$ 135,648**	**$ 134,239**	**$ 316,417**

Recommendation

We recommend that the Carrier reduce the fiscal year 1990, 1991, 1992 and 1993 FACPs by their respective share of the $316,417 for unallowable indirect costs claimed. We also recommend that the Carrier strengthen its internal control procedures to properly identify and segregate unallowable costs.

Carrier's Response

The Carrier concurred with part of the findings and recommendations and disagreed with other parts. The Carrier concurred with:

Topic	Amount
Actuarial Programs	$ 19,264
Treasury Administration	10,358
Executive	77,847
General Corporate	13,626
Use of Budgeted Costs	
Consulting Services	
Special Project	
Investment Firm	
Cost Center 621-05-100	
Cost Center 721-02-000	
Total	$ 316,417

However, the Carrier disagreed with the remaining questioned costs: Subsidiary Audit ($36,345) and Corporate Actuarial ($56,890).

Auditor's Additional Comments

We reviewed the Carrier's response to the Subsidiary Audit and Corporate Actuarial findings in the draft report. Based on this review we determined that the allocation of 2.91 percent to Medicare appeared reasonable and allowable. We revised our findings and recommendation to reflect these costs as allowable.

UNDERSTATED RETURN ON INVESTMENT

The Carrier claimed $644,513 in fiscal year 1990 for return on investment (ROI) on Medicare assets. However, the Carrier provided documentation to support actual ROI of $655,182. Therefore, the Carrier understated allowable ROI by $10,669. ROI is allowable in accordance with FAR 31.205-10 and the Medicare agreement, Appendix B, Section X. A. We reduced the total questioned costs by $10,669 for the allowable ROI not claimed by the Carrier.

Recommendation

We recommend that the Carrier increase the fiscal year 1990 FACP by $10,669 for allowable ROI or offset other questioned costs which result in sustained disallowances.

Carrier's Response

The Carrier concurred with the finding and recommendation. The Carrier stated that this error was of a one-time nature and should not reoccur in future periods.

Auditor's Additional Comments

None.

ADDITIONAL INCENTIVE PAYMENTS

HCFA modified the Medicare Part B contract with the Carrier for fiscal years 1992 and 1993 to provide for incentive payments if the Carrier should incur costs less than established target costs per claim processed. The Carrier received incentive payments in both years. Our review showed that the incentive payments received by the Carrier were consistent with the administrative costs claimed by the Carrier and the terms of the Medicare agreement. However, the results of our audit recommend the reduction of total allowable administrative costs which reduces the associated cost per claim processed. Therefore, based on our audit results, the Carrier is entitled to additioml incentive fees of $622,976 and $182,825 in fiscal years 1992 and 1993, respectively.

We did not review the basis for the established target costs. However, we recommend that HCFA consider the results of the audit and assure that unallowable costs are eliminated from the basis for future negotiated target costs as applicable.

Carrier's Response

The Carrier disagreed that the target costs were overstated. The Carrier stated, in part:

> ". . .The process associated with negotiating a funding level for the upcoming fiscal year is separate from the process of negotiating a target cost for incentive purposes and two different branches within HCFA are responsible for responding to and settling on each proposal. The verbiage contained in the incentive contracts clearly documents the intent on the part of both HCFA and The Travelers to calculate incentive payments using the agreed upon target and audited, allowable costs . . . .
>
> In the case of the allowable costs discussed below that were submitted in revised Final Administrative Cost Proposals, we recalculated the associated incentive award and believe that the award should be recalculated again for purposes of issuing a closing agreement once the results of this most recent audit are finalized.

Auditor's Additional Statement

We recalculated the additional incentive fees due to the Carrier based on the questioned costs and the resulting lower cost per claim. The additional incentive fees were used to reduce the questioned costs in Exhibits 1 through 4.

OTHER MATTERS

In accordance with the Audit Guide, wereviewed andareseparately reporting onthe following issues considered to be Other Matters. These issues are discussed below.

FOLLOW-UP ON PRIOR AUDIT REPORT FINDINGS

The Carrier implemented corrective actions relative to the findings and recommendations of the prior audit with which it agreed and submitted amended FACPs to HCFA. We were able to follow up on the nature and adequacy of the Carrier's corrective actions. Specifically, we determined the Carrier had excluded such costs from the FACPS for fiscal years 1990 through 1993.

However, the Carrier disagreed with and is currently appealing four audit findings from the prior audit report. It has continued to claim these costs in the FACPS for fiscal years 1990 through 1993. See the Findings and Recommendations section of this report for further details on these costs.

Carrier's Response

See the response to Follow up of Prior Audit Findings in the Findings and Recommendations section of this report.

Auditor's Additional Comments

See the Auditor's Additional Comments to Follow up of Prior Audit Findings in the Findings and Recommendations section of this report.

INTERIM EXPENDITURE REPORT

We reviewed the Interim Expenditure Report (IER) for the month of September 1994, along with the methods and procedures for preparing this report. Our limited review disclosed that the IER contained unallowable and unallowable costs as discussed in the Findings and Recommendations section of this report. However, no additional weaknesses were disclosed in the preparation of the IER.

Carrier's Response

None.

Auditor's Additional Statement

None.

COMPLEMENTARY INSURANCE CREDIT

The Carrier was involved with complementary insurance claims processing during our audit period. Our review of the applicable credits and the basis for them disclosed no discrepancies.

Carrier's Response

None.

Auditor's Additional Statement

None.

SIGNIFICANT ELECTRONIC DATA PROCESSING EXPENDITURES

The Carrier did not incur significant electronic data processing (EDP) expenditures in fiscal years 1990 through 1993. The Carrier made a significant change in the expenses processing system, however, no significant EDP expenses were incurred in comection with this change.

Carrier's Response

None.

Auditor's Additional Statement

None.

AREAS OF AUDIT CONCERN

HCFA officials had no other specific areas of concern to be addressed

Carrier's Response

The Carrier provided the following additional statements.

> ". . . submitted revised FACPs for FY 1990 . . . additional, allowable costs related to taxes, the qualified pension plan, EDP Corporate planning and a spreadsheet down load problem . . . . The costs related to the qualified pension plan are documented by the OIG in the audit reports:... HCFA indicated that we could not draw these additional funds until all cost items had been audited to verify their allowability . . . .
>
> . . . the audit report does not reference these costs,... "

Auditor's Additional Statement

The audit report included all costs on the revised FACPS filed on September 30, 1993. However, the scope of the audit did not include pension costs. Therefore, we did not review any costs either incurred or claimed for pensions nor did we comment specifically on the additional costs claimed in the revised FACPS. We recommend that HHS determine the allocability and allowability of the pension costs discussed above.

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INDEPENDENT AUDITOR'S REPORT

We have audited the Medicare Part B Final Administrative Cost Proposals of The Travelers Insurance Company (Travelers) for the period October 1, 1989 through September 30, 1993. These Final Administrative Cost Proposals are the responsibility of the Traveler's management. Our responsibility is to express an opinion on these Final Administrative Cost Proposals based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the *Government Auditing Standards (1988* Revision) published by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts in the Final Administrative Cost Proposals. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentations of the Final Administrative Cost Proposals. We believe that our audit provides a reasonable basis for our opinion.

The accompanying Final Administrative Cost Proposals were prepared to present the cost of administration allowable and applicable to Part B of the Health Insurance for the Aged and Disabled Program pursuant to the reimbursement principles of FAR Part 31, as interpreted and modified by the Medicare agreement. They are not intended to be a complete presentation of the company's assets, liabilities, revenue and expenses.

At the direction of the Department of Health and Human Services, we did not audit the pension costs claimed by Travelers on its Final Administration Cost Proposals. We determined, however, that Travelers had claimed unallowable pension contributions, facility and occupancy costs, tax planning costs, vacant space costs, equipment lease costs, and indirect costs.

In our opinion, except for the unallowable costs referred to in the preceding paragraph, and except for the effects on Exhibits 1 through 4 of such adjustments, if any, as might have been determined to be necessary had our scope not been limited to exclude pension costs, the accompanying Final Administrative Cost Proposals present fairly, in all material respects, the allowable administrative costs incurred under the Medicare agreement and recommended adjustments applicable to Part B of the Health Insurance for the Aged and Disabled Program from October 1, 1989 through September 30, 1993, in accordance with reimbursement principles of FAR Part 31, as interpreted and modified by the Medicare agreement: in conformity with generally accepted accounting principles.

This report is intended solely for the use described above and should not be used for any other purpose.

Tichenor & Associates

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 22, 1994

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

We have audited the Medicare Part B Final Administrative Cost Proposals of The Travelers Insurance Company (Travelers) for the period October 1, 1989 to September 30, 1993, and have issued our report thereon dated November 22, 1994.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards (1988* Revision) issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement.

In planning and performing our audit of the Final Administrative Cost Proposals of Travelers for the period October 1, 1989 through September 30, 1993, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the Final Administrative Cost Proposals and not to provide assurance on the internal control structure.

The management of Travelers is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For purpose of this report, we have classified the significant internal control structure policies and procedures into the following categories:

- Procedures which assure accurate, current and complete disclosure of the financial results of the Medicare program in accordance with Federal reporting requirements;

- Procedures for determining the allowability and allocability of costs in accordance with the FAR Part 31 and Appendix B of the Medicare agreements;

- Cost allocation procedures which assure that indirect costs are accumulated by logical groupings, and distributed on the basis of the benefits accruing to the various cost objectives;

- Records that adequately identify the application of funds;

- Accounting records that are supported by source documentation;

- Effective control over and accountability for all funds, property, and other assets;

- Comparison of actual with budgeted amounts for each period.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize and report financial data consistent with the assertions of management in the Final Administrative Cost Proposals. A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the Final Administrative Cost Proposals being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we noted the following matters involving the internal control structure that we considered to be material weaknesses as defined above.

- Travelers does not have adequate quality assurance procedures for the payroll data being imputed into the Personnel Information Management System to assure that it has been approved by the responsible manager. The Internal Auditors have identified this weakness since 1991, however, no corrective actions have been designed and implemented.

- Travelers does not have adequate procedures for assuring that reimbursable travel costs are adequately documented in accordance with established corporate policies and procedures.

- Travelers does not periodically inventory assets such as furniture and equipment to assure their physical existence is reconciled to the recorded accountability for same.

- Travelers does not have adequate procedures to identify and segregate unallowable costs. As discussed in the Findings and Recommendations section of this report, Travelers charged Medicare unallowable direct and indirect costs. HHS requires that a system of internal control include procedures for reviewing all costs to determine whether costs are allowable and allocable.

- Time sheets were not consistently signed by the employees and in some cases time sheets were missing.

<u>Recommendations:</u>

We recommend that Travelers strengthen its internal control procedures to assure that:

1. Reimbursable travel costs are adequately documented and accounted for to assure compliance with corporate and Federal requirements.

2. Furniture and equipment records are properly maintained and verified and that assets are properly safeguarded.

3. Unallowable costs are identified, segregated and not included in the FACPS.

In our opinion, except for the conditions described above, Travelers' internal controls were adequate for HHS purposes for the period October 1, 1989 to September 30, 1993.

This report is intended for the information of the Department of Health and Human Services and Travelers' management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Tichenor & Associates

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 22, 1994

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE

We have audited the Medicare Part B Final Administrative Cost Proposals of The Travelers Insurance Company (Travelers) for the period October 1, 1989 through September 30, 1993, for its Medicare Part B agreement with HCFA and have issued our report thereon dated November 22, 1994.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards (1988* Revision) issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement.

Compliance with laws and regulations applicable to Travelers is the responsibility of their management. As part of obtaining reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement, we performed tests of the Carrier's compliance with certain provisions of laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in statutes and regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the Final Administrative Cost Proposals. The results of our tests of compliance did not disclose any material instances of noncompliance.

We considered Traveler's compliance with applicable laws and regulations in forming our opinion on whether the Final Administrative Cost Proposals are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated November 22, 1994, on those Final Administrative Cost Proposals.

Except for the unallowable costs charged to the Medicare program as described in the Findings and Recommendations section of this report, the results of our tests of compliance indicated that, with respect to the items tested, Travelers had complied, in all material respects, with the

provisions referred to in the third paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that Travelers had not complied, in all material respects, with those provisions.

This report is intended for the information of the Department of Health and Human Services and the Travelers' management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Tichenor & Associates

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 22, 1994

FINAL ADMINISTRATIVE COST PROPOSALS

Exhibit 1

THE TRAVELERS INSURANCE COMPANY

Final Administrative Cost Proposal

For the Period October 1, 1989 through September 30, 1990

Operation	Costs Claimed	Increase (Decrease) Recommended Adjustments	Footnote Reference
Claims Payment	$ 25,835,053	$	
Reviews and Hearings	1,647,515		
Beneficiary/Physician Inquiry	4,892,627		
Professional Relations	457,318		
Medical and Utility Reviews	3,699,007		
Medicare Secondary Payer	1,212,264		
Participating Physician	522,911		
Productivity Investments	2,168,619		
Other	255,247		
Costs Not Associated With An Operation		(823,427)	(1)
TOTAL	$ 40,690,561	$ (823,427)	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

Exhibit 2

THE TRAVELERS INSURANCE COMPANY

Final Administrative Cost Proposal

Forthe Period Octoberl, 1990 through September 30, 1991

Operation	Costs Claimed	Increase (Decrease) Recommended Adjustments	Footnote Reference
Claims Payment	$ 27,299,305	$	
Reviews and Hearings	1,626,352		
Beneficiary/Physician Inquiry	5,245,474		
Professional Relations	650,617		
Medical and Utility Reviews	3,575,421		
Medicare Secondary Payer	1,458,507		
Participating Physician	451,302		
Productivity investments	600,989		
Other	1,532,900		
Costs Not Associated With An Operation		27,471	(1)
TOTAL	$ 42,440,867	$ 27,471	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

Exhibit 3

THE TRAVELERS INSURANCE COMPANY

Final Administrative Cost Proposal

Forthe Period October 1, 1991 through September 30, 1992

Operation	Costs Claimed	increase (Decrease) Recommended Adjustments	Footnote Reference
Claims Payment	$ 26,512,034	$	
Reviews and Hearings	2,008,501		
Beneficiary/Physician Inquiry	4,844,757		
Professional Relations	782,470		
Medical and Utility Reviews	3,254,228		
Medicare Secondary Payer	1,554,665		
Participating Physician	452,328		
Productivity Investments	2,090,579		
Other	3,420,629		
Costs Not Associated With An Operation		(623,774)	(1)
TOTAL	$ 44,920,191	$ (623,774)	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

Exhibit 4

THE TRAVELERS INSURANCE COMPANY

Final Administrative Cost Proposal

For the Period October 1, 1992 through September 30, 1993

Operation	Costs Claimed	increase (Decrease) Recommended Adjustments	Footnote Reference
Claims Payment	$ 26,141,948	$	
Reviews and Hearings	2,080,004		
Beneficiary/Physician Inquiry	4,395,817		
Professional Relations	789,723		
Medical and Utility Reviews	2,958,633		
Medicare Secondary Payer	2,066,299		
Participating Physician	409,936		
Productivity Investments	3,568,026		
Fraud and Abuse	737,097		
Other	4,764,001		
Costs Not Associated With An Operation		(182,826)	(1)
TOTAL	$ 47,911,484	$ (182,826)	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

APPENDIX

INTERMEDIARY'S WRITTEN RESPONSE

TO

FINDINGS AND RECOMMENDATIONS

SEE APPENDIX FOLLOWING

RAILROAD RETIREMENT BOARD REPORT

REPORT ON

AUDIT OF ADMINISTRATIVE COSTS INCURRED UNDER

PART B OF THE MEDICARE PROGRAM

FOR RAILROAD RETIREMENT BOARD BENEFICIARIES

DURING THE PERIOD

OCTOBER 1, 1989 THROUGH SEPTEMBER 30, 1993

BY

THE TRAVELERS INSURANCE COMPANY

HARTFORD, CONNECTICUT

NOTICE

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of Tichenor & Associates, Certified Public Accountants, as concurred in by the HHS OIG Office of Audit Services. Final determinations on these matters will be made by authorized HHS operating division officials.

CONTRACT DISCLOSURE STATEMENT

This report is made pursuant to Contract HHS-1OO-91 -0030 with Tichenor & Associates, Certified Public Accountants, 12531 Clipper Drive, Suite 202, Woodbridge, Virginia, 22192. Certain information contained herein is subject to disclosure under the Freedom of Information Act, 5 U.S.C. 522(b)4). The Task Monitor was Mr. Robert Champagne, HHS Office of Inspector General, Room 515, 450 Main Street, Hartford, Connecticut, 06103.

The names of the persons employed by Tichenor & Associates, with managerial or professional responsibility for such work, or for the content of the report, are as follows:

Jonathan Crowder, CPA
Deirdra McKenna, CPA
Edward Noble, CPA
Kenneth Wachner, Sr. Auditor

specific financial impact. Otherwise, we believe control procedures were generally adequate for the Department of Health and Human Services' (HHS) purposes, and that the Carrier complied with the terms and provisions of laws and regulations for the transactions tested except they did not have adequate procedures to assure consistent compliance with the Federal travel regulations, did not compute actual costs of ownership for EDP equipment leased from Tower Square Funding, Inc. in order to determine the reasonableness of rental costs claimed and did not use actual costs to allocate credits for complementary insurance claims processed. Tichenor & Associates' reports on its reviews of internal control and on compliance appear on pages 23 and 27, respectively.

We held a departure conference with Carrier representatives on November 22, 1994, the date we concluded our fieldwork. The Carrier was provided with a copy of the draft audit report, to which they provided written comments. We incorporated those comments into the final report. The Carrier concurred with a portion of the total questioned costs such as unallowable indirect costs, understated facility and occupancy costs, understated return on investment, and understated credit for complementary insurance. The Carrier, however, disagreed with the remaining cost findings and recommendations. The Carrier also concurred with all of our internal control findings and recommendations except for periodic inventories of assets with which they did not agree. The Carrier's response is included as an Appendix to this report.

SUMMARY

The Travelers Insurance Company (the Carrier) claimed administrative costs totaling $82,153,761 on its Railroad Retirement Board (RRB) Medicare Part B Final Administrative Cost Proposals (FACPs) for fiscal years ended September 30, 1990, 1991, 1992, and 1993. Our audit disclosed questioned costs of $1,038,408. The audit findings are summarized as follows:

- The Carrier claimed $311,944 of facilities and occupancy costs for space in excess of 135 net-usable square feet per equivalent man-year as allowed by the contract. Also, the Carrier allocated facility and occupancy costs based on budgeted rates rather than actual rates.

- The Carrier claimed current costs of $390,864 for indirect costs which were identified as unallowable during prior audits of Medicare administrative costs. Claiming costs which were previously identified as unallowable is unallowable in accordance with the Medicare agreement, Article XIII, paragraph L. These unallowable indirect costs included $242,232 for certain leased equipment which is unallowable in accordance with FAR 31.201-4; $152,714 for vacant space which is unallowable in accordance with FAR 31.205-17; $8,236 for tax planning costs which is unallowable in accordance with FAR 3 1.205-41(b)(l) and 31.205-27(a); and, $(12,3 18) for pension contributions which are unallowable in accordance with FAR 3 1.205-6(j)(2)(ii) and Cost Accounting Standards (CAS) 412.40.

- The Carrier understated the credit for processing complementary insurance claims by $201,400. Credits to the program must be made in accordance with FAR 31.201-5.

- The Carrier claimed $138,896 in unallowable indirect costs including (1) cost centers that do not benefit Medicare, (2) costs not incurred, (3) unsupported costs, (4) unallowable costs, and (5) cost centers inconsistently allocated.

- The Carrier understated the allowable costs for return on investment (ROI) by $4,696 in fiscal year 1990. These costs are allowable in accordance with FAR 31.205-10 and Medicare Appendix B, Section X.A.

We evaluated the Carrier's system of significant internal accounting and administrative controls and its compliance with laws and regulations that can materially affect the Carrier's FACPS. Our evaluation, in addition to the above recommended adjustments, disclosed internal control weaknesses in the inventory control and travel expense systems; however, we identified no

TABLE OF CONTENTS

PAGE

SUMMARY i

INTRODUCTION 1
Background 1
Regulations Relating to Cost Reimbursement 2
Scope ofAudit 3

FINDINGS AND RECOMMENDATIONS 4
Unallowable Facility and Occupancy Costs 4
Follow Up OfPrior Audit Findings 6
Understated Credit for Complementary Insurance 13
Unallowable Indirect Costs... 13
Understated RetumonInvestment . . . .-.17

OTHER MATTERS 18
Follow-Up On Prior Audit Report Findings 18
Interim Expenditure Report 18
Complementary Insurance Credit... 19
Significant Electronic Data Processing Expenditures 19
Areas of Audit Concer n...... 20

INDEPENDENT AUDITOR'S REPORT 21

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL 23

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE 27

FINAL ADMINISTRATIVE COST PROPOSALS 29
Exhibit l- Fiscal Year 1990..... 30
Exhibit 2- Fiscal Year 1991 31
Exhibit 3- Fiscal Year 1992 32
Exhibit 4- Fiscal Year 1993 33

APPENDIX - Carrier's Written Response to Findings and Recommendations 34

INTRODUCTION

The information contained in this report relates to an audit of administrative costs incurred under Title XVIII, Part B, of the Social Security Act for medical claims for Railroad Retirement Board beneficiaries by The Travelers Insurance Company (the Carrier) during the four-year period October 1, 1989 through September 30, 1993.

BACKGROUND

Health Insurance for the Aged and Disabled (Medicare), Title XVIII of the Social Security Act, provides a hospital insurance program and a related medical insurance program for (a) eligible persons aged 65 and over; (b) disabled persons under 65 who are entitled to Social Security or Railroad Retirement disability benefits for at least 24 consecutive months; and (c) individuals under 65 with chronic kidney disease who are currently insured by or entitled to Social Security benefits.

The hospital insurance program, Part B, Supplementary Medical Insurance Benefits for the Aged and Disabled, is a voluntary program and provides protection against the costs of physician's services, hospital outpatient services, home health care services and other health services. The Medicare program is administered by the Health Care Financing Administration (HCFA). Title XVIII provides, however, that public or private organizations, known as carriers (Part B), may assist in the program's administration.

Carriers are reimbursed for all reasonable and allowable costs incurred in administering the programs, except for specific limitations that may be agreed to in the individual Medicare contracts and agreements. During the four-year period covered by our audit, the Carrier served as the carrier in administering Medicare Part B claims for Railroad Retirement Board beneficiaries nationwide.

During the audit period, October 1, 1989 through September 30, 1993, the Carrier processed about 47.9 million claims, paid Medicare Part B benefits for Railroad Retirement Board beneficiaries totaling about $2.9 billion, and claimed administrative costs of $82.2 million for this period as follows:

Period	Claimed costs	Claims Processed
10/1/89 - 9/30/90	$21,433,497	10,797,467
10/1/90 - 9/30/91	20,221,109	11,684,485
10/1/91 - 9/30/92	20,110,835	12,402,305
10/1/92 - 9/30/93	20,388,320	13,095,927
TOTAL	$82,153,761	47,980,184

Costs incurred in connection with the Carrier's activities are accumulated in cost centers which are subsequently allocated to its various lines ofbusiness, including its Medicare Part B line of business.

REGULATIONS RELATING TO COST REIMBURSEMENT

Article XV of the Medicare agreement states that allowable costs under the agreement shall be determined in accordance with the provisions of Part 31 of the Federal Acquisition Regulation (FAR) as interpreted and modified by Appendix B to the agreement. Section 31.201-1 of the FAR provides that the total cost of a contract is the sum of the allowable direct and indirect costs allocable to a contract, incurred or to be incurred, less any applicable credits.

FAR Part 31 also provides that items of cost are allowable charges provided that the tests of reasonableness and allocability are met and that generally accepted accounting principles are followed. A reasonable cost is defined as one that would be incurred by an ordinarily prudent person in the conduct of competitive business. Further, a cost is allocable if it is assigned or chargeable to a particular cost objective in reasonable proportion to the benefits received.

Sections 31.202 and 31.203 of the FAR define direct and indirect costs as follows:

> Direct Costs: Any cost that can be identified specifically with a particular cost objective. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly thereto. Costs identified specifically with other work of the Carrier are direct costs of that work and are not to be charged to the contract directly or indirectly.
>
> Indirect Costs: Any cost that, because of its incurrence for common or joint objectives, is not readily subject to treatment as a direct cost.

Finally, Section 31.205 of the FAR provides detailed guidelines as to whether or under what circumstances specific types of costs are allowable or unallowable.

SCOPE OF AUDIT

We audited the Railroad Retirement Board, Medicare Part B Final Administrative Cost Proposals (FACPS) of The Travelers Insurance Company (the Carrier) for the period October 1, 1989 through September 30, 1993. The FACPs are the responsibility the Carrier's management. Our responsibility is to express an opinion on these FACPS based on our audit.

Our examination was made in accordance with generally accepted auditing standards and with the *Government Auditing Standards (1988* Revision) issued by the Comptroller General of the United States. The primary purpose of the examination was to express an opinion as to whether the Carrier's FACPS present fairly the allowable costs of administration in conformity with the reimbursement principles contained in Part 31 of the FAR as interpreted and modified by the Medicare agreement. The examination included an evaluation of the accounting system and related internal controls, tests of the accounting records, and the application of the auditing procedures contained in the *Audit Guide for the Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers Under Title XVIII of the Social Security Act* (Audit Guide) issued by the Department of Health and Human Services Office of Inspector General in March 1991. However, at the direction of the Department of Health and Human Services (HHS), Office of Inspector General (OIG), we did not audit the Carrier's pension plans.

The audit fieldwork was conducted at The Travelers Insurance Company, Hartford, Connecticut, during the period August 15, 1994 through November 22, 1994.

This report is intended solely for the purpose described above and should not be used for any other purpose.

FINDINGS AND RECOMMENDATIONS

For the period October 1, 1989 through September 30, 1993, the Carrier claimed administrative costs totaling $82,153,761 on its Railroad Board Medicare Part B FACPS. Our audit disclosed questioned costs of $1,038,408 as unallowable in accordance with applicable Federal regulations and the terms and conditions of the Medicare agreement as follows:

Summary of Claimed and Questioned Costs 10/1/89 through 9/30/93			
Period	Claimed costs	Questioned costs	Reference
10/1/89 - 9/30/90	$ 21,433,497	$ 263,356	Exhibit 1
10/1/90 - 9/30/91	20,221,109	(80,886)	Exhibit 2
10/1/91 - 9/30/92	20,110,835	555,797	Exhibit 3
10/1/92 - 9/30/93	20,388,320	300,141	Exhibit 4
TOTAL	$ 82,153,761	$ 1,038,408	

Our detailed findings and recommendations are discussed below.

UNALLOWABLE FACILITY AND OCCUPANCY COSTS

The Carrier claimed $311,944 of facility and occupancy (F&O) costs for space exceeding 135 net-usable square feet per equivalent man-year. The allocation of space in excess of 135 net-usable square feet per equivalent man-year is unallowable in accordance with Appendix B, Section X. B. 1. to the Medicare contract, which states:

> "With respect to space, either leased or owned, acquired after the effective date of this agreement/contract, the guideline for the amount of such space which may hereafter be allocated for the performance functions under this agreement/contract to the Medicare program, without justification by the contractor, shall be an average of 135 square feet of net usable space per equivalent man-year. Additional amounts of space may be allocated, provided that the contractor justifies such additional amounts. "

We determined that the Carrier has not submitted a request to HCFA justifying the allocation of greater than 135 net-usable square feet per equivalent man-year to the Medicare program. We also determined that the Carrier had allocated indirect facility costs based on budgeted average costs per square foot which were not adjusted to actual. We determined that budgeted and actual indirect facility costs per square foot were as follow:

Fiscal Year	Budgeted/Claimed Rate	Actual Rate
1990	$24.14	$25.09
1991	$24.44	$25.04
1992	$21.45	$21.75
1993	$21.26	$22.32

The use of budgeted rates versus actual rates resulted in an understatement of the indirect facility costs. Therefore, we calculated the total actual F&O costs using the actual rates shown above. We then calculated the unallowable F&O costs by determining the excess square feet allocated to Medicare and multiplying it by the average cost per square foot for the Carrier's home offices. The results of the calculations were netted together to determine the total unallowable costs. Our audit disclosed unallowable facility and occupancy costs of $311,944 as follows:

Fiscal Year	Total F&O costs	Total Sq. Ft. Allocated	Excess Sq. Ft.	Questioned Costs
1990	$1,475,884	145	10	$ 67,898
1991	1,363,974	141	6	33,421
1992	1,505,591	155	20	152,200
1993	1,324,910	146	11	58,425
TOTAL	$5,670,359			$ 311,944

Recommendation

We recommend that the Carrier reduce the fiscal year 1990, 1991, 1992 and 1993 FACPS by their respective share of the $311,944 for unallowable facility and occupancy costs claimed.

Carrier's Response

The Carrier summarized their position as follows:

> "This audit finding is comprised of two issues: the use of budgeted versus actual rates which caused costs to be understated . . . and excess square footage. The net amount . . . was questioned in the audit reports.

> We agree with the audit finding relative to the use of budgeted versus actual rates " which resulted in an understatement of costs for the four fiscal years . . . .
>
> We disagree with the second component of the finding that recommends disallowance of net usable square feet in excess of the contractual 135 square feet on the basis that the Government is estopped from retroactively requiring Travelers to include corporate home office space in the calculation of net usable square feet. In addition to that argument, we have also included justification for the additional post-1978 space and maintain that space acquired prior to 1978 should have been excluded from the auditor's calculation but was not . ..."

Auditor's Additional Comments

Although the Carrier stated that the Government has previously not required the inclusion of corporate home office space in the calculation of total facility and occupancy costs subject to the 135 square foot limitation, we have determined that the facility and occupancy finding developed in a prior audit of fiscal years 1984 and 1985, were consistent with our basis. Furthermore, our findings were developed in accordance with Appendix B to the Medicare agreement. The final determination as to the allowability of the questioned facility and occupancy costs is a legal matter which is outside of the scope of our audit. Therefore, we continue to include the applicable corporate home office space in the calculation of net usable square feet. We concur that space that was acquired, and not modified through lease amendment, prior to October 1978 should not be included in the calculation of net usable square feet and the personnel residing in that space should not be included in the calculation of the net equivalent man years. The Carrier provided additional data to support the calculation of these items. We considered and evaluated this information in determining the revised allowable and unallowable costs.

FOLLOW UP OF PRIOR AUDIT FINDINGS

The Carrier claimed $390,864 for indirect costs which were identified as unallowable during prior audits of Medicare administrative costs. The fiscal year 1988-1989 audit questioned costs claimed for allocated vacant space, tax planning costs, leased equipment costs and pension contributions. These findings were sustained by HCFA as documented in the Audit Clearance Document dated December 16, 1991. However, the Carrier did not concur with the finding or determination and, according to HHS OIG, has appealed the decision.

The Medicare contract, Article XIII, paragraph L., states:

> "If the Secretary and the Intermediary are unable to agree upon a final amount of the administrative costs of the Intermediary for a particular period, the Secretary shall issue a final determination of the amount of such administrative costs for such period and inform the Intermediary of such costs, with a full explanation of the exceptions he has taken to the Intermediary's report of its

allowable costs. If a dispute arises as to the exceptions taken by the Secretary, the Intermediary may appeal the final determination in accordance with the provisions of Article XXI of this agreement.... Where a particular cost or type of cost is disallowed by final determination of the Secretary and the Intermediary is not in agreement with the Secretary's disallowance, the Intermediary will, for subsequent claims, abide by the decision of the Secretary and agrees not to be reimbursed, pending resolution of any amounts of such costs. Until the issue is resolved, the Intermediary will segregate such costs from all others, and specify the amounts of such costs on all subsequent claims." (Emphasis added)

Therefore, these costs should have been specifically identified by the Carrier as not reimbursable pending the outcome of the appeal process. The unallowable costs were identified as follows:

Cost Category	1990	1991	1992	Total	Note
Vacant Space	$ 62,747	$ 45,918	$ 44,049	$ 152,714	(1)
Leased Equipment	18,165	110,653	113,414	242,232	(2)
Tax Planning	2,778	2,452	3,006	8,236	(3)
Pension Contributions	106,534	(284,223)	165,371	(12,318)	(4)
TOTAL	$ 190,224	$ (125,200)	$ 325,840	$ 390,864	

Note:

(1) Vacant Space

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Carrier allocated costs to the Medicare program for vacant space. We determined that the Carrier claimed $152,714 for vacant space in fiscal years 1990 through 1992. The allocation of idle facilities and idle capacity costs to the Medicare contract are unallowable in accordance with FAR 31.205-17 which states:

"The costs of idle facilities are unallowable... "

Therefore, we continue to classify the costs claimed for vacant space as unallowable under the current Medicare program.'

(2) Leased Equipment

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Carrier allocated costs to the Medicare program for leased equipment which did not benefit the Medicare program. We determined that the Carrier claimed $242,232 for leased equipment which they could not demonstrate benefitted the Medicare contract in fiscal years 1990 through 1992. The allocation of costs to the Medicare contract is unallowable in accordance with FAR 31.201-4 if no benefit is received by the program.

Therefore, we continue to classify the costs claimed for leased equipment which does not benefit the Medicare program as unallowable under the current Medicare program.

(3) Tax Planning

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Carrier allocated costs to the Medicare program from responsibility code 115-04-100 Tax Planning. We determined that the Carrier claimed $8,236 for the tax planning cost center in fiscal years 1990 through 1992. This cost center is responsible for Federal, State and foreign tax planning, development of tax policies relating to tax laws, and the acquisition of companies or business segments. FAR 31.205-41(b)(l) states:

> "The following types of costs are not allowable: (1) Federal income and excess profit taxes."

Also, FAR 31.205-27(a) states, in part:

> ". . . expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business including mergers and acquisitions . . . are unallowable."

Therefore, we continue to classify the costs claimed for the Tax Planning responsibility code as unallowable under the current Medicare program.

(4) Pension Contributions

The Medicare administrative cost audit for fiscal years 1988 and 1989 determined that the Carrier claimed costs under the Medicare program for unfunded nonqualified pension contributions. We did not perform a review of the pension costs claimed by the Carrier. However, during our review of the prior audit findings and our determination of their disposition, we determined that the Carrier had continued to claim unallowable pension costs as reported in the prior audit. The Carrier provided the amount, by fiscal year, which had been claimed but was unallowable for fiscal years 1990 to 1992. These amounts included credits for fiscal year 1991.

The Carrier stated that the credits are due to timing differences created due to the reporting period, calendar year versus fiscal year, and the funding of an unqualified pension plan which is adjusted on a calendar basis and may include credits from prior periods. We did not determine whether the amounts provided by the Carrier were supported by the accounting records since pension costs had been excluded from the scope of our audit. However, we recommend that HCFA verify that the amounts, including the credits, are accurate.

The Carrier claimed $(12,3 18) for the same unqualified pension contributions in fiscal years 1990 through 1992. FAR 3 1.205-6(j)(2)(ii) does not allow costs of pension plans that are discriminatory to the Federal Government. Medicare is the only line of business currently funding its entire share of the pension plan. The costs of the plan for other lines of business are accrued but not funded until benefits are due to participants. This practice is discriminatory to the Federal Government. In addition, the Cost Accounting Standards (CAS) 412.40 (c) do not allow the cost of pension plans if the payment of benefits from the plan cannot be compelled by the participants. The Carrier could not clearly illustrate that the benefits under the nonqualified plan can be legally compelled. The unallowable costs are the difference between the excess pension costs claimed over the pension costs funded.

Recommendation

We recommend that the Carrier reduce the fiscal year 1990, 1991 and 1993 FACPS by their respective share of the $390,864 for unallowable costs which continue to be claimed although they have been identified as unallowable in prior audits.

Carrier's Response

The Carrier disagreed with the finding and recommendation. The Carrier stated, in part:

> "...These issues were under dispute from the audit of fiscal years 1988 and 1989 . . . these costs were not audited during the current audit. We were requested to quantify the costs that were claimed during the four fiscal years and were informed that Tichenor & Associates could not render an opinion as to the allowability of these costs, but that these cost issues would be decided based on the resolution of the fiscal years 1988 and 1989 dispute.
>
> We recently reached a tentative settlement with HCFA on these four issues and propose that these costs in fiscal years 1990 through 1993 be resolved similarly. We support the decision made by HCFA related to the allowability of these costs. Each of the four items is addressed below:
>
> A. Vacant **Space**
>
> These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. Our reasoning is restated below:...

I

. . the FAR permits the allowability of idle facilities costs when they are necessary to meet fluctuations in workload, or when they were necessary when acquired and are now idle because of reasonably unforeseen changes in requirements . . . .

Travelers vacant space costs are allowable under these express cost allowability principles. The Travelers vacant space policy[1] is that rent is charged to the Vacant Space cost center when a "tenant" (a Travelers Department or unit) moves out of an area as a result of a Corporate directive and in accord with the Master Space Plan (MSP) . . . . The vacant space cost center is also used when tenants are moved to temporary space while their permanent location is renovated. The tenant is charged for the temporary space while the area under renovation is charged to vacant space. Thus, Travelers vacant space involves both idle capacity as well as idle facilities.

As can be seen from Travelers' vacant space policy, the vacant space charges relating to idle facilities arise from changed requirements, reorganization changes, production economies, and other causes, all of which factors Travelers takes into consideration under its MSP in assigning space. In addition, the vacant space charges arising from idle capacity are clearly the result of normal business fluctuations, not subject to reduction or elimination, such as when space is being renovated.

B. Lease Equipment

These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. Our reasoning is restated below:...

. . . in mid-1988, Travelers chose to lease, rather than purchase, its ADP equipment needs. This option offered Travelers certain financial advantages.

When Travelers made lease payments to the lessor, Travelers booked the amortized equipment amount to the responsibility code which "manages 'f the equipment repayment. The costs are built into the charge rates of the Data Center, and are allocated to Medicare based on the usage of the DP cost centers. . . . Thus, Medicare bore its proportional share of an allowable and necessary business expense.

[1]Travelers set forth this policy and additional explanation on these costs in its May 30th, 1991 response to the draft audit report.

C. Tax **Planning**

These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. Our reasoning is restated below:...

. . . the Tax Planning Center is occasionally involved in analyzing the tax consequences of the proposed acquisition or disposition of various business segments or subsidiaries, its role does not extend to the "planning or execution of the organization or reorganization" of a business as described in FAR $31.205-27 . . . .

Second,... .The costs of preparing and submitting business tax forms are expressly allowable under FAR $31.205 -28,....

. . . Thus, the Tax Planning Center costs associated with filing Federal Income tax forms are expressly allowable costs under FAR $31.205-28.

D. Pension Contributions

We propose settling on the unqualified plan using the same methodology that was used to settle this issue for fiscal years 1988 and 1989. Ron Solomon, HCFA, OACT, in his memo dated April 28, 1994, recommended that, "Since ultimate payment of accrued, but not projected, benefits is secured by the amendments, the government will consider accrual costs for the value of only the accrued benefits as allocable and allowable contract costs without regard to funding. This recommendation is to apply to costs for all years beginning with fiscal year 1987, notwithstanding the fact that the FAR change was not effective until fiscal year 1990. "

For the four fiscal years, we claimed a total of $48,682 on our FACPS. The revaluation by our actuaries indicates that the total allowable cost for the period was $771,929. Therefore, we understated our costs by $723,247 for FY 90 through 91. These additional costs should be considered as part of the settlement for these years. " (Parts A, B, and RRB)

<u>Auditor's Additional Comments</u>

A. Vacant Space

The Carrier stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Carrier did not provide any additional documentation to supper that this decision had been changed.

In addition, the Carrier provided their Master Space-Plan policy stating that the only facility costs incurred for vacant space are those associated with changed requirements, reorganization changes, production economies and other causes which should be interpreted as allowable under FAR 31.205-17. However, we are aware of downsizing actions taken by the Carrier as a result of corporate reorganizations planned, pending, or initiated, which result in permanent reductions and vacant space which is unallowable idle facility costs. Therefore, our finding and recommendation remain unchanged.

B. **Leased Equipment**

The Carrier stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Carrier did not provide any additional documentation to support that this decision had been changed.

The Carrier did not address the allocability of the costs based on benefit, nor did they address how the leased equipment directly benefitted the Medicare program. Therefore, our finding and recommendation remain unchanged.

C. Tax **Planning**

The Carrier stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Carrier did not provide any additional documentation to support that this decision had been changed.

In a January 4, 1991 memorandum prepared by the Carrier, this cost center's functions were described as including the monitoring of tax legislation and working with industry groups to minimize cost to the Carrier, as well as tax planning and administration. We questioned all costs claimed because the Carrier did not segregate and eliminate from their claim the following explicitly unallowable functions: 1) those which influence tax legislation unallowable under FAR 31.205-22 and, 2) tax planning and administration functions which are unallowable under FAR 31.205-28, which allows only the cost of tax preparation and submission. Therefore, our finding and recommendation remain unchanged.

D. Pension

The Carrier stated that these costs were deemed allowable by HCFA. We reviewed the clearance documents from the prior audit referenced and determined that the questioned costs had been upheld by HHS. The Carrier did not provide any additional documentation to support that this decision had been changed.

Pension costs were not included in the scope of our audit. Therefore, we cannot determine whether the additional pension costs discussed by the Carrier are allowable, allocable, and reimbursable in accordance with the FAR and Medicare agreement. Therefore, our finding and recommendation remain unchanged.

UNDERSTATED CREDIT FOR COMPLEMENTARY INSURANCE

In fiscal years 1992 and 1993, the Carrier understated the credit in the Medicare program for complementary insurance claims processed under the RRB contract by $201,400. The Carrier did not properly accumulate the number of complementary claims processed due to a system error in counting claims in excess of 9,999 per day. This resulted in an understatement of $10,6OO in fiscal year 1992 and $190,800 in fiscal year 1993. Credits allocable to Medicare must be credited as a cost reduction or refunded in cash in accordance with FAR 31.201-5.

Recommendation

We recommend that the Carrier reduce the fiscal year 1992 and 1993 FACPs by their respective share of the $201,400 of understated complementary insurance credits. Also, we recommend that the Carrier correct the system of accumulating claims to assure proper counting of claims of 9,999.

Carrier's Response

The Carrier concurred with the Finding and Recommendation. The Carrier stated that the ". . .understatement of the credit was caused by a systems error that was discovered in October, 1994. The programming has been corrected and credits for complementary insurance have been properly accumulated and reported in subsequent periods. "

Auditor's Additional Comments

None.

UNALLOWABLE INDIRECT COSTS

The Carrier claimed $138,896 of unallowable indirect costs for fiscal years 1990 through 1993. The unallowable costs resulted from the following:

- The Carrier allocated $9,798 from a cost center which did not benefit the Medicare program. The Carrier was unable to demonstrate how the costs incurred and allocated from the Actuarial Programs and Resources (111-01-200) responsibility codes provided a benefit to the Medicare program. This responsibility code is allocated to the Medicare program based on a factor of 2.91 percent. However, because this responsibility code provided no benefit to the Medicare program the allocated costs are unallowable in accordance with FAR 31.201-4, which states, in part:

> "A cost is allocable if is assignable or chargeable to one or more cost objectives on the basis of relative benefits received... "

In addition, the Medicare contract, Appendix B, Section XV, paragraph A.3., states:

> "The following hems are unallowable:.. .A.. .(3) costs relating to the contractor's underwriting activities, including related actuarial . . . services... "

- The Carrier allocated $48,013 from responsibility codes which are unallowable in accordance with the FAR. Unallowable activities were performed in the Treasury Administration (112-04-100), Executive (121-01-000) and General Corporate (142-02-100) responsibility codes. Based on our inquiries, it was determined that personnel from these responsibility codes spent between 10 percent and 33 percent of their time on activities related to the selling of subsidiaries, merging and/or acquiring companies and raising capital. FAR 31.205-27(a) states, in part:

  > ". . . expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions, (2) . . change in the controlling interest in the ownership of a business, and (3) raising capital... are unallowable. "

- The Carrier claimed indirect costs based on budgeted cost allocations to the Medicare program which were not adjusted to actual costs. In fiscal years 1992 and 1993, the Carrier changed the methodology for allocating Corporate and Staff (C&S) responsibility codes to the Medicare and other lines of business. Prior to fiscal year 1992, actual costs were allocated from these responsibility codes to the various lines of business. However, beginning in fiscal year 1992 the Carrier began grouping these responsibility codes together and allocating the combined final budget amounts to the lines of business. We determined that the allocated amounts were not adjusted to actual costs. Instead any variance was charged directly to a corporate responsibility code which was not allocated to any lines of business. The use of budgeted cost allocations resulted in an overstatement of $70,194 of Medicare costs allocated from these cost centers. These costs are unallowable in accordance with FAR 31.201.

- The Carrier was unable to provide supporting documentation to determine the allowability, allocability and reasonableness of $9,703 of costs allocated from the Executive responsibility code (12 1-01-000) for consulting services performed by a former officer. In addition, costs were allocated from this responsibility code for a special engagement performed by the Carrier's independent public accounting firm which was unrelated to the annual financial statement audit and which did not appear to benefit the Medicare program, and services of an investment firm. Costs which do not benefit the Medicare program are unallowable in accordance with FAR 31.204. Costs associated with investment counseling do not benefit the Medicare program and are also unallowable in accordance with FAR 31.205-27(a).

- The Carrier identified and segregated indirect responsibility codes which they determined were not allocable to Medicare in preparing the FACPs. However, the Carrier was not consistent in eliminating MCEBO: IO (621-05-100) and United Way Campaign Expenses (721-02-000) from the FACP in each fiscal years 1991 and 1992 and claimed $1,188 associated with these responsibility codes. These responsibility codes are unallowable in accordance with FAR 31.201-4 because they do not benefit the Medicare program.

We summarized the unallowable indirect costs claimed as a result of these conditions as follows:

	FY 1990	FY 1991	FY 1992	FY 1993	TOTAL
Cost Centers Not Benefiting Medicare					
Actuarial Programs	$ 3,113	$ 1,638	$ 2,535	$ 2,512	$ 9,798
Claimed Costs Unallowed by FAR					
Treasury Administration	$ 1,134	$ 868	$ 2,025	$ 1,017	$ 5,044
Executive	4,918	4,982	14,203	12,662	36,765
General Corporate	765	1,663	1,799	1,977	6,204
Subtotal	$ 6,817	$ 7,513	$ 18,027	$ 15,656	$ 48,013
Budgeted Rather Than Actual Costs					
Various	$ 0	$ 0	$ 37,505	$ 32,689	$ 70,194
No Supporting Documentation					
Consulting Services	$ 0	$ 1,097	$ 2,772	$ 0	$ 3,869
Speciat project	0	0	2,003	0	2,003
Investment Firm	0	0	3,831	0	3,831
Subtotal	$ 0	$ 1,097	$ 8,606	$ 0	$ 9,703
Overlooked Eliminating Cost Centers					
Center 621-05-100	$ 0	$ 0	$ 192	$ 59	$ 251
Center 721-02-000	0	645	292	0	937
Subtotal	$ 0	$ 645	$ 484	$ 59	$ 1,188
GRAND TOTAL	$ 9,930	$ 10,893	$ 67,157	$ 50,916	$ 138,896

Recommendation

We recommend that the Carrier reduce the fiscal year 1990, 1991, 1992 and 1993 FACPs by their respective share of the $138,896 for unallowable indirect costs claimed. We also recommend that the Carrier strengthen its internal control procedures to properly identify and segregate unallowable costs.

Carrier's Response

The Carrier concurred with part of the findings and recommendations and disagreed with other parts. The Carrier concurred with:

Topic	Amount
Actuarial Programs	$ 9,798
Treasury Administration	5,044
Executive	36,765
General Corporate	6,204
Use of Budgeted Costs	70,194
Consulting Services	3,869
Special Project	2,003
Investment Firm	3,831
Cost Center 621-05-100	251
Cost Center 721-02-000	937
Total	$ 138,896

However, the Carrier disagreed with the remaining questioned costs: Subsidiary Audit ($17, 178) and Corporate Actuarial ($28,566).

Auditor's Additional Comments

We reviewed the Carrier's response to the Subsidiary Audit and Corporate Actuarial findings in the draft report. Based on this review we determined that the allocation of 2.91 percent to Medicare appeared reasonable and allowable. We revised our finding and recommendation to reflect these costs as allowable.

UNDERSTATED RETURN ON INVESTMENT

The Carrier claimed $322,604 in fiscal year 1990 for return on investment (ROI) on Medicare assets. However, the Carrier provided documentation to support actual ROI of $327,300. Therefore, the Carrier understated allowable ROI by $4,696. ROI is allowable in accordance with FAR 31.205-10 and the Medicare agreement, Appendix B, Section X. A. We reduced the total questioned costs by $4,696 for the allowable ROI not claimed by the Carrier.

Recommendation

We recommend that the Carrier increase the fiscal year 1990 FACP by $4,696 for allowable ROI or offset other questioned costs which result in sustained disallowances.

Carrier's Response

The Carrier concurred with the finding and recommendation. The Carrier stated that this error was of a one-time nature and should not reoccur in future periods.

Auditor's Additional Comments

None.

OTHER MATTERS

In accordance with the Audit Guide, we reviewed and are separately reporting on the following issues considered to be Other Matters. These issues are discussed below.

FOLLOW-UP ON PRIOR AUDIT REPORT FINDINGS

The Carrier implemented corrective actions relative to the findings and recommendations of the prior audit with which it agreed and submitted amended FACPs to HCFA. We were able to follow up on the nature and adequacy of the Carrier's corrective actions. Specifically, we determined the Carrier had excluded such costs from the FACPS for fiscal years 1990 through 1993.

However, the Carrier disagreed with and is currently appealing four audit findings from the prior audit report. It has continued to claim these costs in the FACPS for fiscal years 1990 through 1993. See the Findings and Recommendations section of this report for further details on these costs.

Carrier's Response

See the response to Follow up of Prior Audit Findings in the Findings and Recommendations section of this report.

Auditor's Additional Comments

See the Auditor's Additional Comments to Follow up of Prior Audit Findings in the Findings and Recommendations section of this report.

INTERIM EXPENDITURE REPORT

The Interim Expenditure Report (IER) for the month of September, 1994, was reviewed along with the methods and procedures for preparing this report. Our limited review disclosed that the IER contained unallowable and unallowable costs as discussed in the Findings and Recommendations section of this report. However, no additional weaknesses were disclosed in the preparation of the IER.

Carrier's Response

None.

Auditor's Additional Statement

None.

COMPLEMENTARY INSURANCE CREDIT

The Carrier was involved with complementary insurance claims processing during our audit period. See the Findings and Recommendations section of this report for discussion of complementary insurance credits.

Carrier's Response

See the response to Understated Credit for Complementary Insurance in the Findings and Recommendations section of this report.

Auditor's Additional Comments

See the Auditor's Additional Comments to Understated Credit for Complementary Insurance in the Findings and Recommendations section of this report.

SIGNIFICANT ELECTRONIC DATA PROCESSING EXPENDITURES

The Carrier did not incur significant electronic data processing (EDP) expenditures in fiscal years 1990 through 1993. The Carrier made a significant change in the expenses processing system, however no significant EDP expenses were incurred in connection with this change.

Carrier's Response

None.

Auditor's Additional Statement

None.

AREAS OF AUDIT CONCERN

RRB officials asked us to renew the reasonability of costs claimed (pension, EDP, postage, rent, furniture and non EDP equipment) and the reasonability of fiscal year 1993 claims processed at Connecticut and Virginia.

Based upon our audit work as incorporated in this report we questioned rent costs due to excess and vacant space as well as budgetary rather than actual cost based submissions. We determined claim volume at Connecticut and Virginia to be reasonable in light of overloads at other RRB processing facilities.

Carrier's Response

The Carrier provided the following additional statements.

> "... submitted revised FACPS for FY 1990.. additional, allowable costs related to taxes, the qualified pension plan, EDP Corporate planning and a spreadsheet down load problem . . . . The costs related to the qualified pension plan are documented by the OIG in the audit reports:... HCFA indicated that we could not draw these additional funds until all cost items had been audited to verify their allowability . . . .
>
> . . the audit report does not reference these costs,... "

Auditor's Additional Statement

The audit report included all costs on the revised FACPS filed on September 30, 1993. However, the scope of the audit did not include pension costs. Therefore, we did not review any costs either incurred or claimed for pensions nor did we comment specifically on the additional costs claimed in the revised FACPS. We recommend that HHS determine the allocability and allowability of the pension costs discussed above.

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INDEPENDENT AUDITOR'S REPORT

We have audited the Medicare Part B, Railroad Retirement Board Final Administrative Cost Proposals of The Travelers Insurance Company (Travelers) for the period October 1, 1989 through September 30, 1993. These Final Administrative Cost Proposals are the responsibility of the Traveler's management. Our responsibility is to express an opinion on these Final Administrative Cost Proposals based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the *Government Auditing Standards (1988* Revision) published by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts in the Final Administrative Cost Proposals. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentations of the Final Administrative Cost Proposals. We believe that our audit provides a reasonable basis for our opinion.

The accompanying Final Administrative Cost Proposals were prepared to present the cost of administration allowable and applicable to Part B of the Health Insurance for the Aged and Disabled Program pursuant to the reimbursement principles of FAR Part 31, as interpreted and modified by the Medicare agreement. They are not intended to be a complete presentation of the company's assets, liabilities, revenue and expenses.

At the direction of the Department of Health and Human Services, we did not audit the pension costs claimed by Travelers on its Final Administration Cost Proposals. We determined, however, that Travelers had claimed unallowable pension contributions, facility and occupancy costs, tax planning costs, vacant space costs, equipment lease costs, and indirect costs. The Travelers had also understated the allowable return on investment and the credit for complementary insurance.

In our opinion, except for the unallowable costs referred to in the preceding paragraph, and except for the effects on Exhibits 1 through 4 of such adjustments, if any, as might have been determined to be necessary had our scope not been limited to exclude pension costs, the accompanying Final Administrative Cost Proposals present fairly, in all material respects, the allowable administrative costs incurred under the Medicare agreement and recommended adjustments applicable to Part B of the Health Insurance for the Aged and Disabled Program from October 1, 1989 through September 30, 1993, in accordance with reimbursement principles of FAR Part 31, as interpreted and modified by the Medicare agreement, in conformity with generally accepted accounting principles.

This report is intended solely for the use described above and should not be used for any other purpose.

Tichenor & Associates

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 22, 1994

TICHENOR & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS and MANAGEMENT CONSULTANTS

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

We have audited the Medicare Part B, Railroad Retirement Board Final Administrative Cost Proposals of The Travelers Insurance Company (Travelers) for the period October 1, 1989 to September 30, 1993, and have issued our report thereon dated November 22, 1994.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards (1988* Revision) issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement.

In planning and performing our audit of the Final Administrative Cost Proposals of Travelers for the period October 1, 1989 through September 30, 1993, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the Final Administrative Cost Proposals and not to provide assurance on the internal control structure.

The management of Travelers is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For purpose of this report, we have classified the significant internal control structure policies and procedures into the following categories:

- Procedures which assure accurate, current and complete disclosure of the financial results of the Medicare program in accordance with Federal reporting requirements;

- Procedures for determining the allowability and allocability of costs in accordance with the FAR Part 31 and Appendix B of the Medicare agreements;

- Cost allocation procedures which assure that indirect costs are accumulated by logical groupings, and distributed on the basis of the benefits accruing to the various cost objectives;

- Records that adequately identify the application of finds;

- Accounting records that are supported by source documentation;

- Effective control over and accountability for all funds, property, and other assets;

- Comparison of actual with budgeted amounts for each period.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize and report financial data consistent with the assertions of management in the Final Administrative Cost Proposals. A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the Final Administrative Cost Proposals being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we noted the following matters involving the internal control structure that we considered to be material weaknesses as defined above.

- Travelers does not have adequate quality assurance procedures for the payroll data being imputed into the Personnel Information Management System to assure that it has been approved by the responsible manager. The Internal Auditors have identified this weakness since 1991, however, no corrective actions have been designed and implemented.

- Travelers does not have adequate procedures for assuring that reimbursable travel costs are adequately documented in accordance with established corporate policies and procedures.

- Travelers does not periodically inventory assets such as furniture and equipment to assure their physical existence is reconciled to their recorded accountability for same.

- Travelers does not have adequate procedures to identify and segregate unallowable costs. As discussed in the Findings and Recommendations section of this report, Travelers charged Medicare unallowable direct and indirect costs. HHS requires that a system of internal control include procedures for reviewing all costs to determine whether costs are allowable and allocable.

- Time sheets were missing for several employees.

<u>Recommendations</u>:

We recommend that Travelers strengthen its internal control procedures to assure that:

1. Reimbursable travel costs are adequately documented and accounted for to assure compliance with corporate and Federal requirements.

2. Furniture and equipment records are properly maintained and verified and that assets are properly safeguarded.

3. Unallowable costs are identified, segregated and not included in the FACPS.

In our opinion, except for the conditions described above, Travelers' internal controls were adequate for HHS purposes for the period October 1, 1989 to September 30, 1993.

This report is intended for the information of the Department of Health and Human Services and Travelers' management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Tichenor & Associates

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 22, 1994

TICHENOR & ASSOCIATES
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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE

We have audited the Medicare Part B, Railroad Retirement Board Final Administrative Cost Proposals of The Travelers Insurance Company (Travelers) for the period October 1, 1989 through September 30, 1993 for its Medicare Part B agreement with HCFA and have issued our report thereon dated November 22, 1994.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards (1988* Revision) issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement.

Compliance with laws and regulations applicable to Travelers is the responsibility of their management. As part of obtaining reasonable assurance about whether the Final Administrative Cost Proposals are free of material misstatement, we performed tests of the Carrier's compliance with certain provisions of laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in statutes and regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the Final Administrative Cost Proposals. The results of our tests of compliance did not disclose any material instances of noncompliance.

We considered Traveler's compliance with applicable laws and regulations in forming our opinion on whether the Final Administrative Cost Proposals are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated November 22, 1994, on those Final Administrative Cost Proposals.

Except for the unallowable costs charged to the Medicare program as described in the Findings and Recommendations section of this report, the results of our tests of compliance indicated that, with respect to the items tested, Travelers had complied, in all material respects, with the

provisions referred to in the third paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that Travelers had not complied, in all material respects, with those provisions.

This report is intended for the information of the Department of Health and Human Services and the Travelers' management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Tichenor & Associates

TICHENOR & ASSOCIATES
Woodbridge, Virginia
November 22, 1994

FINAL ADMINISTRATIVE COST PROPOSALS

Exhibit 1

THE TRAVELERS INSURANCE COMPANY

Final Administrative Cost Proposal

For the Period October 1, 1989 through September 30, 1990

Operation	Costs Claimed	Increase (Decrease) Recommended Adjustments	Footnote Reference
Claims Payment	$ 13,815,477	$	
Reviews and Hearings	1,076,446		
Beneficiary/Physician Inquiry	4,169,907		
Professional Relations	31,270		
Medical and Utility Reviews	1,344,551		
Medicare Secondary Payer	454,103		
Participating Physician	277,074		
Productivity Investments	220,454		
Other	44,215		
Costs Not Associated With An Operation		(263,356)	(1)
TOTAL	$ 21,433,497	$ (263,356)	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

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Exhibit 2

THE TRAVELERS **INSURANCE** COMPANY

Final Administrative Cost Proposal

Forthe Period Octoberl, 1990 through September 30, 1991

Operation	Costs Claimed	Increase (Decrease) Recommended Adjustments	Footnote Reference
Claims Payment	$ 13.745,453	$	
Reviews and Hearings	1,075,728		
Beneficiary/Physician Inquiry	3,209,059		
Professional Relations	89,312		
Medical and Utility Reviews	1,188,760		
Medicare Secondary Payer	415,405		
Participating Physician	260,099		
Productivity Investments	237,293		
Costs Not Associated With An Operation		80,886	(1)
TOTAL	$ 20,221,109	$ 80,886	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

Exhibit 3

THE TRAVELERS INSURANCE COMPANY

Final Administrative Cost Proposal

Forthe Period Octoberl, 1991 through September 30, 1992

Operation	Costs Claimed	Increase (Decrease) Recornrnended Adjustments	Footnote Reference
Claims Payment	$ 13,017,4621	$	
Reviews and Hearings	1,225,899		
Beneficial/Physician Inquiry	3,224,827		
Professional Relations	111,730		
Medical and Utility Reviews	1,175,607		
Medicare Secondary Payer	474,285		
Participating Physician	135,780		
Productivity Investments	745,245		
Costs Not Associated With An Operation		(555,797)	(1)
TOTAL	$ 20,110,835	$ (555,797)!	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

Exhibit 4

THE TRAVELERS INSURANCE COMPANY

Final Administrative Cost Proposal

Forthe Period Octoberl, 1992 through September 30, 1993

Operation	Costs Claimed	Increase (Decrease) Recommended Adjustments	Footnote Reference
Claims Payment	$ 13,557,205	$	
Reviews and Hearings	1,084,868		
Beneficiary/Physician Inquiry	3,539,433		
Professional Relations	114,461		
Medical and Utility Reviews	1,001,253		
Medicare Secondary Payer	461,310		
Participating Physician	131,917		
Productivity Investments	260,517		
Fraud and Abuse	237,356		
Costs Not Associated With An Operation		(300,141)	(1)
TOTAL	$ 20,388,320	$ (300,141)	

(1) See Findings and Recommendations section of this report. The opinion of Tichenor & Associates on this FACP appears on Page 21.

APPENDIX

CARRIER'S WRITTEN RESPONSE

TO

FINDINGS AND RECOMMENDATIONS

MEDICARE

July 6, 1995

received
7/7/95

Ms. Dierdre C. McKenna
Tichenor & Associates
12531 Clipper Drive, Suite 202
Woodbndge, VA 22192

RE: The Travelers Insurance Company
Medicare Administration Costs
Response to Draft Audit Reports
October, 1 1989 through September, 301993

Dear Ms. McKenna:

We have reviewed the Draft Audit Reports of The Travelers Administrative Costs for the period October 1, 1989 through September 30, 1993. Enclosed are our responses to the audit findings included in your report.

In summary, of the total amount questioned of $5,797,423, we agree that costs were understated by $287,274 and disagree with $5,312,768. In addition, our response also claims additional costs of $2,710,328 that should be included as part of the settlement for these years. The attached table documents our conclusions for each audit finding.

We appreciate the opportunity to comment on these reports.

Very truly yours,

Margaret C Christophy

Margaret C. Christophy, CPA
CFO, Government Operations

cc: R. Ogden, OIG
R. Champagne, OIG
J. Feldheim, RRB
J. Giansante, RRB
P. Hamel, HCFA
W. Bannon, MH
T. Ryan, MH
J. Me[z, TIC
W.B. Shirk, Seyforth, Shaw, et. al.

METRAHEALTH
One Tower Square, Hartford, CT. 06183
MetraHealth Insurance Company

Travelers Conclusions on

Audit Findings

FY 1990 through FY 1993

Topic	Agree	Disagree	Total
Excess Space	(243,696)	3,432,174	3,188,478
Prior Audit Findings			
Vacant *Space*	0	*595,852*	595,852
Leased Equipment	0	1,099,845	1,099,845
Tax Planning		*32,986*	32,986
Pension Contributions	(723,247;	0	48,682
Understated Complementary Insurance	201,400	0	201,400
Unallowable Indirect Costs			
Actuarial Programs	31,956	0	31,956
Subsidiary Audit	0	*58,723*	58,723
Corporate Actuarial	0	*93,188*	93,188
C/aimed Costs Unallowed by FAR	162,609	0	162,609
Budgeted vs *Actual Costs*	262,540	0	262,540
No Supporting Documentation	32,493	0	32,493
Overbooked Eliminating Cost Centers	4,036	0	4,036
Understated Return On Investment	(15,365)	o	(15,365)
Summary of Audit Findings	(287,274)	5,312,768	5,797,423
Costs Claimed on Revised FACPs	(2,61 1,673)		
Disputed Costs Excluded from FY 93	(98,655)		
TOTAL	(2,997,602)		

FINDINGS AND RECOMMENDATIONS

1. UNALLOCABLE FACILITY AND OCCUPANCY COSTS

a. Summary of Travelers' Position

This audit finding is comprised of two issues: the *use* of budgeted versus actual rates which caused costs to be understated by $243,696 and excess square footage which totals $3,432,174. The net amount of $3,188,478 was questioned in the audit reports.

We agree with the audit finding relative to the use of budgeted versus actual rates which resulted in an understatement of costs for the four fiscal years of $243,696.

We disagree with the second component of the finding that recommends disallowance of net usable square feet in excess of the contractual 135 square feet on the basis that the Government is estopped from retroactively requiring Travelers to include corporate home office space in the calculation of net usable square feet. In addition to that argument, we have also included justification for the additional post-1 978 space and maintain that space acquired prior to 1978 should have been excluded from the auditors' calculation but was not. The estoppel argument is set out below in Section b.

b. Position of Estoppel

The Government Is Estopped from Retroactively Requiring Travelers To Include Corporate Home Office Space In The Calculation Of Net-Usable Space Per Equivalent Man-Year

A. FACTS

By letter of May 9, 1995, enclosing the Government's draft audit reports of the Final Administrative Cost Proposals (FACPs) submitted by the Travelers Insurance Company (Travelers) for the period October l, 1989 through September 30, 1993, the Government for the first time informed Travelers that the Government now included corporate home office space within the calculation of 135 net-usable square feet per equivalent man-year. [1] The audit reports each contained a similar finding that Travelers had claimed certain amounts of facility and occupancy (F&O) costs for space exceeding 135 net-usable square feet per equivalent man-year. Specifically, the Government found that the

[1] Under the Medicare Part B Railroad Retirement Board contract, the Government recommended disallowance of $884,949 "unallowable" F&O costs. Under the Medicare Part A contract, the Government recommended disallowance of $303,307 'unallowable" F&O costs. Finally, under the Medicare Part B contract, the Government recommended disallowance of $2,243,918 "unallowable" F&O costs.

allocation of space in excess of 135 net-usable square feet per equivalent man-year was unallowable in accordance with Appendix B, Section X. B. 1. (the same in all 3 contracts) to the Medicare contract which states:

> With respect to space, either leased or owned, acquired after the effective date of this agreement/contract, the guideline for the amount of such space which may hereafter be allocated for the performance functions under this agreement/contract to the Medicare program, without justification by the contractor, shall be an average of 135 square feet of net usable space per equivalent man-year. Additional amounts of space may be allocated, provided that the contractor justifies such additional amounts.

The Government determined with respect to each contract audited (Medicare Part A, Medicare Part B, Medicare Part B Railroad Retirement Board) that Travelers had not submitted a request to HCFA justifying the allocation of greater than 135 net-usable square feet per equivalent man-year.

In calculating Travelers net-usable square feet per equivalent man-year, the auditors for the first time since 1978 (the time when the above "net-usable square feet" clause was inserted into Travelers contracts) included Travelers corporate home office space in the square footage included in the calculation.2 Prior to this audit, neither the Government nor Travelers ever included Travelers corporate home office space in the calculation of net-usable square feet per equivalent man-years

The Government was, however, fully aware from prior audits and complete access to Travelers expense reports of the existence of the corporate home office space during the period of contract performance (1978- 1995). More particularly, the Government had access to the current and prior FACPS. These proposals all include Travelers <u>total</u> facility and occupancy costs as a separate line

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2 While the audit reports do not expressly state that Travelers corporate home office space is the primary cause of the overrun, it is obvious from the auditors' work papers, and from prior audit findings, that this is the case. The auditors asked for and were provided with Travelers worksheet calculating square footage for only Medicare space for FY 90-93. This calculation is consistent with the reamer in which Travelers has historically provided this information to auditors. Travelers' worksheet calculating square footage for space dedicated exclusively to Medicare work (hereafter called <u>direct</u> Medicare space) for FY 90-93 documents that direct space for these years is, in each year, less than the 135 square footage guidelines. Only when the corporate home office space is included in the calculation does the square footage significantly exceed the 135 square footage guideline, as found by the auditors. We use the term corporate home office space here to include all indirect corporate space, as opposed to space exclusively dedicated to Medicare work.

3 In fact, when corporate home office space is added into the square footage calculation for FY 84-86, Travelers F&O costs significantly exceed the 135 square feet limitation. (See Attachment 1.) However, the Government did not include the corporate home office space in that calculation in the audits for FY 84-86.

item which include indirect corporate home office expenses. 4 In addition, throughout the 1980s during the budget negotiations with the Government, Travelers was required to submit Facility and Occupancy Schedules (Form HCFA-3259 - see Attachment 2) to each budget request. Travelers completed a separate schedule for each field office, with one for the home office allocations which included both Medicare home office and Corporate allocations. The Government never once challenged or questioned square footage during the budget negotiations.

Even with the knowledge that Travelers had significant corporate home office space, it was still the Government's practice from 1978 until the present to include only Medicare-dedicated space in this calculation. For reasons of which we are unaware, in 1994 the Government auditors changed the Government's interpretation of what should be included in the calculation of net-usable square feet per equivalent man-year. The Government knew of and consistently accepted the fact that Travelers facilities and occupancy costs did not include this space in its 135 net-usable square feet per equivalent man-year calculation, and Travelers reasonably relied to its detriment, on the Government's acceptance by continuing to exclude corporate home office space from its F&O calculations, the Government is now estopped from retroactively disallowing such costs.

Notably, had Travelers known that the Government interpreted the net-usable square footage requirement *to* include corporate home office space (purchased after 1978 as set forth in the contract clause), it would not have made the decision to utilize the Norcross, Georgia facility, which was constructed in 1981, for its Medicare processing needs. Rather, Travelers would likely have fulfilled these requirements at its ADP Center in Hartford, Connecticut, which was built and acquired by Travelers prior to 1978 (and, thus, would be excluded from the 135 square footage calculation under the contract).5

---

4 The FACPs include all of Travelers proposed administrative costs, only one element of which is facility and occupancy costs. As parts of the facility and occupancy costs, Travelers includes amounts attributable to Medicare <u>direct</u> space as well as <u>indirect</u> space, which is the corporate home office allocation. Only direct Medicare space was subjected to the 135 square foot limitation prior to 1994.

5 Both the Norcross, Georgia and the Hartford, Connecticut ADP facilities are part of the corporate home office space (i.e. indirect costs), as opposed to Medicare direct space. Thus, the Travelers Medicare home office is allocated its proportional share of the cost of these facilities by the Travelers corporate home office.

Under Travelers Medicare contracts, the 135 square foot limitation only became applicable in 1978. The clause, as set forth above, explicitly "grandfathered in" corporate home office space acquired or leased by Travelers prior to 1978. Thus, any Travelers corporate home office space acquired prior to 1978 need not be included in the 135 square footage calculation.

B. ANALYSIS

The Government Cannot Retroactively Disallow Travelers F&O Costs Related To Corporate Home Office Space.

As noted above, for the years 1978 nearly to the present, neither Travelers nor the Government interpreted the calculation of net usable square feet per equivalent man-year as including corporate home office space. During this entire period, the Government was fully aware that while Travelers did not include this space in its net usable square feet calculation it certainly absorbed and charged to the Government facility and occupancy costs allocated to it by its corporate home office. Both parties accepted this practice -- Travelers to its detriment. Now, the Government is attempting to change the rules of the game retroactively. However, under applicable caselaw, the Government is estopped from doing so.

The weight of authority in the courts and in the Boards of Contract Appeals stands for the proposition that a retroactive cost disallowance will not be permitted where:

> . . . the cost or accounting method in question had been accepted, the contractor reasonably believed that it would continue to be approved, and relied upon such reasonable belief to its detriment.

Data-Design Laboratories, ASBCA No. 21,029, 81-2 BCA ¶ 15,190 (1981) at 75,172.

This same proposition is applicable to the facts presented here. The Government clearly knew of the existence of Travelers corporate home office space. As noted above, the Government had complete access to all of Travelers FACPs and expense reports during the period 1978 through the present. These proposals and reports clearly evidenced the fact that Travelers was incurring rents and related occupancy expenses with respect to corporate facilities. In fact, the parties negotiated over these costs during annual budget negotiations. The Government also clearly knew that Travelers did not include this space in its calculation of net-usable square feet per equivalent man-year. Based on the parties' established practice, Travelers reasonably believed that its 135 net-usable square feet space calculations, which excluded the corporate space, would continue to be approved during the period FY 1990 to 1993, and it relied upon the Government's prior acceptance of these calculations to its detriment. Thus, the Government is estopped from retroactively changing the definition or interpretation of what space is to be included in the calculation of net-usable square feet per equivalent man-year for the years 1990 to 1993. As Judge Littleton eloquently stated the law:

> When a party with knowledge or the means of knowledge of his rights and of the material facts does what amounts to a recognition of the transaction as existing, or permits the other party to deal with the subject matter under the belief that the transaction is recognized, *or abstains for a considerable length of time from impeaching it, so that the other party is reasonably induced to suppose that it is recognized*, there is acquiescence, and the transaction, though it be originally impeachable, becomes unimpeachable. (emphasis added).

Harvey Radio Laboratories. Inc. v. United States, 126 Ct. Cl. 383, 391-92 (1953) (citations omitted)

In Litton Systems. Inc. v. United States, 196 Ct. Cl. 133, 449 F.2d 392 (1971), the Court of Claims laid the groundwork for the plethora of retroactive disallowance cases that followed. The contractor in Litton appealed an adverse decision of the ASBCA which had held the Government entitled to disallow a portion of Litton's claims for reimbursement of general and administrative expenses ("G& A") under CPFF contracts performed during the contractor's 1959 through 1965 fiscal years.

During that period, Litton distributed its G & A expenses using a cost-of-sales base. On its fixed price contracts, Litton followed the common accounting practice of treating the sale of an item as having occurred when it effected delivery to the customer. On its CPFF contracts, however, Litton treated each cost reimbursement billing as a sale. The effect of this inconsistency in the definition of "sale" was to postpone the impact of costs incurred under fixed price contracts while simultaneously accelerating similar costs incurred under CPFF contracts. Thus, G & A expenses for a given period were loaded disproportionately to CPFF contracts. Since Litton's fixed price contract volume was increasing relative to its volume of CPFF contracts in the years in question, more G & A expense was being absorbed by CPFF contracts than would have been the case had the contractor followed a consistent practice of apportioning its G & A expense between CPFF and fixed price contracts. The Court concluded with respect to this arrangement that while the contractor's G & A allocation method may not have been proper:

> That conclusion does not, however put an end to the controversy. It simply leads to the further question of whether the Board properly approved the Government's insistence that a new G & A allocation method be applied to contracts performed during plaintiffs fiscal years beginning August 1, 1958.

Litton Systems, Inc., 196 Ct. Cl. at 132.

The Government first questioned the contractors accounting practice in a meeting on June 27, 1960. Thereafter, exchanges of correspondence and discussions continued throughout 1961 and 1962. Finally, on December 3, 1962, the Government auditor issued a DD Form 396 (the predecessor of the Form 1) disallowing claimed reimbursement under Litton's CPFF contracts in excess of the amount allocable on a cost input basis for the contractor's 1959 fiscal year. The Court of Claims held the Government's actions to be improper:

> *In view of plaintiff's long* and consistent use of the cost of sales method *with the government knowledge, approval and acquiescence, plaintiff was entitled to reasonable adequate notice that the Government would no longer approve the use of that method with* respect to the CPFF contracts. . . Such notice was essential in order to enable plaintiff to recover the additional G & A expense that would be allocable to its fixed price contract as a result of the shift in accounting methods. (emphasis added)

Litton Systems, Inc. 196 Ct. Cl. at 148.

Similarly, in view of Travelers "long and consistent" interpretation and use of the net usable square feet calculation as *not* including corporate home office space, with the Government's complete knowledge and acquiescence, Travelers is entitled to notice of the Government's intent to change its interpretation of what is included in the calculation of net-usable square feet. Under the holding of Litton, and the cases that followed, the Government may not, as it is attempting to do here, retroactively change the game rules.

After the Court of Claims decided Litton, the Armed Services Board of Contract Appeals ("ASBCA") decided Sanders Associates. Inc., ASBCA No. 15,518, 73-2 BCA ¶ 10,055 (1973). There, during 1966 the contractor changed its method of apportioning overhead from an individual cost center basis to a company-wide overhead structure under which overhead expenses were accumulated throughout the company and a corporate rate derived. The various divisions then applied this corporate rate. At the time this change was made, Sanders established a new operating division, Data Systems Division, which was almost entirely a commercial business. The engineering and manufacturing overhead rates of Data Systems Division were far higher than the company-wide rates of which they became a part under the contractors company-wide overhead rate structure.

On November 16, 1967, DCAA expressed concern as to the inclusion of Data Systems' overhead expenses in company-wide overhead pools. However, on January 16, 1968, DCAA provisionally approved Sanders' company-wide rate approach for billing purposes. In addition, DCAA approved final overhead rates for fiscal year (FY) 67 in August 1968. There was no discussion preceding that approval of the propriety of the company-wide rates nor of the disparities between individual cost centers, nor did DCAA take any exception to the inclusion of Data Systems' overhead expenses in the corporate pools.

In late 1968, DCAA sent the contractor a draft of a letter which pointed out distortions caused by Sanders' central overhead allocation method and recommended that company-wide rates be discontinued. The draft warned that DCAA would recommend use of individual cost center rates in pricing fixed price contracts in FY 70 and future years if Sanders refused to agree. Thereafter, on January 9, 1969, DCAA recommended deletion of Data Systems' indirect expenses from Sanders' overhead rate submission in evaluating a fixed price subcontract proposal.

Sanders, by letter of January 21, 1969, disputed DCAA's conclusion regarding the overhead allocation method. By letter of March 6, 1969, DCAA replied repeating its earlier position. Finally, on September 10, 1969, the parties reached an agreement along the lines of DCAA's position which was to be prospective in application.

In the interim, however, i.e., before the parties had reached an agreement, Sanders had submitted its proposed final overhead rates for FY 68. On April 1, 1970, DCM issued a Form 1 disapproving inclusion of Data Systems' overhead expenses in the FY 68 company-wide rate submission. As with the Court's decision in Litton, the ASBCA found Sanders' accounting practice to be questionable, but noted:

> The question remains, however, whether the Government's retroactive adjustment to Appellant's overhead structure was proper. We do not regard as material in answering that

> question whether that action constituted a change in accounting method or in the accounting treatment to be accorded costs. Rather the criterion should be whether under the circumstances the contractor reasonably believed that the Government would allow it to continue to include the expenses of Data Systems in its company-wide overhead pools and acted on that belief to its detriment. With respect to the latter point, *the Court of Claims did not require a specific showing of. . . reliance on the past approval of the Government but, in effect, found such detrimental reliance to be selfevident.*

Sanders, 73-2 BCA at 47,164. (emphasis added).

The ASBCA thus concluded:

> Accordingly, the Government should have known when it approved the FY 1968 rates that the overhead expenses of Data Systems would have a significant effect on the FY 1968 rates of the company. Its silent approval of the FY 1967 rates, therefore, together with the continued approval of rates for forward pricing of fixed price contracts to the end of calendar year 1968, gave appellant reasonable grounds to believe that the Government did not object *per se,* to the inclusion of Data Systems' overhead.
>
> Under the circumstances, appellant was entitled to actual prior notice that the Government would no longer approve such inclusion. . .

Sanders, 73-2 BCA at 47,165.

Sanders was followed in the Board by Falcon Research and Development Company, ASBCA No. 19,784, 77-1 BCA ¶ 12,312; *aff'd on recon. 77-2* BCA ¶ 12,795. In Falcon Research, the appellant's corporate parent assessed what it termed an "optimum asset utilization charge" (OAUC) against appellant which was calculated on the basis of the amount of non-productive assets being carried by the appellant. The charge was designated "interest" on the corporate parent's invoices although there was no correlation to borrowings or interest payments by the parent or by appellant. The OAUC assessment was invoiced to appellant during its FY 70 and FY 71 and was charged to the Government as part of its approved overhead billing rate *on* CPFF contracts. DCAA subsequently audited appellant's FY 70 and FY 71 overhead accounts and approved final overhead rates for those years, with full knowledge of the OAUC charges.

In July 1973, a new DCAA auditor audited appellant's 1972 overhead and raised a question as to whether the OAUC was an unallowable interest payment. In 1974, DCAA issued a Form 1 questioning OAUC allocations relative to all of appellant's cost reimbursement contracts for FYs 70, 71 and 72. The administrative contracting officer issued a final decision formalizing the retroactive disallowance and the contractor appealed.

In sustaining the appeal, the Board held:

> The central issue in this appeal is whether *the contracting officer may validly reopen appellant's approved overhead rates for several years past, and with respect to all of appellant's cost-reimbursement contracts, retroactively disallow one of the cost elements in (he approved overheadpool. The* Boards and Court of Claims have held that this may not be done in cases where the overhead costs or accounting method had been accepted and the contractor reasonably believed it would continue to be approved and relied thereon to its detriment . . . This principle applies even in circumstances where the claimed overhead costs, viewed *ab initio*, would be unallowable under the applicable cost principles.
> (emphasis added).

Falcon Research, 77-1 BCA at 59,484.

The next case in which the board considered the "estopped" question was Data-Design Laboratories, ASBCA No. 21,029, 81-2 BCA ¶ 15,190 (1981). In that case, the contract in question was a CPFF contract awarded in 1972. The dispute between the Government and the contractor revolved around the ASPR travel cost principle:

> The difference in cost between first-class air accommodations and less than first-class air accommodations is unallowable except when less than fist-class accommodations are not reasonably available to meet necessary mission requirements, such as, where less than first-class accommodations would:
>
> (i) require circuitous routing,
>
> (ii) require travel during unreasonable hours,
>
> (iii) greatly increase the duration of the flight,
>
> (iv) result in additional costs, which would offset the transportation savings,
>
> (v) offer accommodations which are not reasonably adequate for the physical or medical needs of the traveler.

The contractor's policy was to allow first-class travel since travel was to be performed as much as possible outside normal working hours. In recording air fare costs, the contractor did not segregate or separately record first-class air fare costs or the difference between first-class and lower-class fares, believing that if travel were performed during normal duty hours the salary cost would offset the first-class differential. The Government was aware, during all years prior to FY 74, that the contractor's personnel were using first-class air travel and that the contractor believed that first-class travel expenses were allowable under the travel cost principle.

The issue of first-class travel was first raised by the Government in a meeting on March 1, 1972 between the contractor's president and representatives of DCAA, but the issue was not resolved. Thereafter, in a 1973 contract negotiation, a contracting officer allowed the contractor's proposed first-class air travel costs. However, in September 1973, DCASR conducted a compensation review and recommended that the travel policy be amended to specify coach-class air fare accommodations. The review was forwarded to the contractor by letter of January 24, 1974. It was not until July 1, 1975, however, that DCAA issued its Form 1 disallowance of 1973 first-class air travel. The contractor appealed this disallowance. The Board, while finding the contractor's travel policy to be noncompliance, also held the Government's retroactive disallowance to be improper.

> Appellant contends that the cost disallowance was retroactive in nature and was therefore improper. We agree.
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> ******
>
> Moreover, the record of this proceeding is replete with instances in which auditors either (a) accepted appellant's travel costs but were silent on the first class air travel policy, (b) questioned specific trips as having occurred during working hours, but, implicitly, approved appellant's basic policy where the trips did occur outside of working hours, or (c) specifically found the first class differential to be reimbursable under ASPR 15.205.46 based upon appellant's rationale.
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>
> We conclude, further, that appellant relied upon the apparent Government approval to its detriment. The record demonstrates that, during discussions of the issue with Government representatives, appellant expressed that if the Government were to disallow the first class air fare costs appellant would have to modify its travel policy. We have found that if the Government had disapproved of the costs at an *earlier* date, appellant would have made those modifications and, in fact, we see that when the costs were ultimately disallowed appellant instructed its employees to travel in less than first class accommodations, albeit during working hours.
>
> ******
>
> Based upon the foregoing, we *conclude that it was not until appellant received the 31 July 1975 DCAA Form 1 that it was authoritatively informed of the Government's position regarding appellant's first class airfare policy, that the disapproval of appellant's 1973 first class air travel was an improper retroactive disallowance, and that appellant is entitled to recover [he 1973* costs *agreed upon by stipulation.*
> (emphasis added)

Data Design Laboratories, 81-2 BCA at pp. 75,172-75,174.

Finally, the Board again addressed the issue of retroactive disallowance in Gould Defense Systems, Inc., ASBCA No. 24,881, 83-2 BCA ¶ 16,676 (1983). In Gould, the dispute centered around CAS 414, Facilities Capital Cost of Money. The Government challenged Gould's amortization of goodwill which had resulted from Gould's merger with another corporation in 1969. CAS 414 first became applicable to Gould for its FY 1977, beginning January 1. Gould included projected amortization in its CAS 414 facilities capital cost of money computation in its forward pricing proposal for the years 1977-1980. DCAA audited this proposal in January 1977. DCAA did not take exception to the facilities capital at that time, and the corporate ACO subsequently concurred with the DCAA's finding that the amount of facilities' capital in the contractor's proposal was a reasonable projection. Thereafter, the cost of money factors contained in Gould's audited proposal were used by it in the negotiation and pricing of contracts up until October 11, 1979.

In November 1978, DCAA conducted an audit of Gould's actual cost of money allocation for the year 1977. Following guidance issued by DCAA headquarters in June 1978, the DCAA auditor questioned Gould's inclusion of goodwill in the facilities capital cost of money calculation. On February 23, 1979, the ACO wrote to Gould's president advising him of an initial finding of noncompliance and soliciting his assistance in resolving an impasse that had developed under CAS 414. The letter requested that Gould advise the ACO of its position and proposed corrective action. On October 11, 1979, the Government and Gould entered into a contract which excluded the goodwill amortization factor from the contractor's cost of money calculation, but permitted an adjustment of the price if it were later determined that goodwill was includable. This clause was repeated in subsequent contracts.

On October 25, 1979, DCAA issued a Form 1 disallowance against a CPFF contract awarded on December 19, 1977, which disallowed the goodwill component of facilities capital cost of money which had been paid under the contract in 1977, 1978 and 1979. In pricing the contract, Gould had used the 1977-1980 forward pricing rates *accepted by the Government* in January 1977. Gould appealed the Form 1 disallowance.

The Board's lengthy analysis of the merits of the CAS 414 issue concluded that facilities capital might properly include a goodwill amortization component, but not on the facts of this case. However, the Board sustained Gould's appeal on the basis of estoppel:

> As pertinent to this appeal, the Government is estopped from contesting the inclusion of appellant's goodwill in its facilities capital if four elements are present (1) the Government must have known at the time of the forward pricing audit that the contractor included goodwill in its computation of facilities capital; (2) the Government must intend that the results of its forward pricing audit would be acted on by the contractor, or the contractor has a right to believe that the forward pricing audit could be relied on; (3) the contractor must in fact rely reasonably on the Government's audit to its detriment; (4) the contractor must not be aware that the Government's intention was that the forward pricing audit was not binding concerning the inclusion of goodwill. This rule is to be compared with the related precept that the Government may not disallow retroactively historical costs where: The cost or accounting method in question previously had been accepted following final audit of historical costs; the contractor reasonably believed that it would continue to be approved; and it detrimentally relied on the prior acceptance. *The retroactive disallowance rule applies regardless of the allowability of the historical cost under the Defense Acquisition Regulations and requires that the Government only may disallow the cost or method prospectively.*
> (emphasis added)
>
> ******
>
> Whereas invocation of the retroactive disallowance rule has been premised on the contractor's reliance on final historical cost audits, the rule, nevertheless, is a special application of

> estoppel principles. The general rules governing application of the doctrine of equitable estoppel cost disputes are not limited necessarily to situations where the cost or accounting method in question has been accepted previously by the Government following final audit. Assuming that the prerequisites to finding an estoppel otherwise are establish an estoppel will lie against the Government where it unequivocally accepts a contractor's proposed accounting treatment in an audit conducted, *inter alia*, for the purposes of forward pricing.
>
> *We believe the contractors are entitled to a greater degree of certainty in their financial dealings with the Government.* Once the Government unequivocally takes its stand and reads and applies the standard in the same manner as the contractor, it is essential that the contractor be entitled to rely on that joint interpretation until notified otherwise. *This rule is essential to the orderly conduct of business with the Government and is applicable irrespective of whether a Defense Acquisition cost principle or a Cost Accounting Standard is involved.* (emphasis added)
>
> ******
>
> In light of the discussion above, the Government may disallow only prospectively appellant's facilities capital cost of money to the extent goodwill was included.

Gould, 83-2 BCA at pp. 82,981-82,984 (citations omitted).[6]

The cases discussed at length above, while different somewhat factually, all share the common elements of estoppel, which are also present in Travelers case: knowledge, acceptance and detrimental reliance. The cases conclusively establish that in Travelers case the Government cannot retroactively challenge the exclusion of corporate home office space where Travelers has always excluded such space from the calculation of the 135 square feet net-usable per equivalent man-year, and such exclusion was acquiesced in by the Government. Travelers and HCFA not only established a course of conduct extending over some fifteen years, but the parties negotiated budgets and closures of contracts, and resolved numerous audit questions. During the entire period, the Government knew about and acquiesced in Travelers method of computing its 135 net-usable square feet per equivalent man-year calculation, which method excluded the corporate home office space. Had Travelers known that the Government interpreted "net-usable space" as including the corporate home office space, it could and would have justified this additional space to HCFA, as required under the clause. In addition, Travelers would not have moved its Medicare ADP center from its 1968 Hartford facility to its 1981 Georgia facility. Thus, because the Government knew of Travelers interpretation of what constituted net-usable space, and Travelers relied upon the Government's acquiescence to its detriment, there is no question but that the rule against retroactive disallowance of costs applies to this case.

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6 See also, Symetrics Engineering Corporation, NASA BCA No. 1270-20, 74-1 BCA ¶ 10,553; Wolf Research and Development Corporation, ASBCA No. 10,913, 69-2 BCA ¶ 8017 and Webster Contractors, ASBCA No. 24,641, 83-1 BCA ¶16,467.

C. CONCLUSION

The Government is estopped from disallowing Travelers F&O costs related to the corporate home office space during the period 1990-1993. The Govemrnent knowingly accepted Travelers' space calculations, which excluded the corporate home office space, until 199S, and Travelers relied on the Government's acceptance and acquiescence to its detriment. Thus, all of the elements necessary to invoke the rule against retroactive disallowance are present: knowledge, acceptance and detrimental reliance. Accordingly, the Government is estopped from challenging Travelers exclusion of corporate home office space from its 135 net-usable square feet per equivalent man-year calculation during the 1990-1994 timeframe.

c. Position on Pre-1978 Space

The audit finding was calculated based on total Facility and Occupancy costs documented in the Cost Classification Report submitted with each Final Administrative Cost Proposal. Implicit in this approach is the assumption that all of our direct and indirect space was acquired subsequent to 1978 which is when this space requirement was included in our contracts. Appendix B, Section X. B. 1. states:

> "With respect to space, either leased or owned, acquired after the effective date of this agreement/contract. .."

This provision is clearly intended to exclude from the calculation space that was leased or owned prior to the effective date which was 1978.

Most of our corporate structures were built prior to 1978 and should have been excluded from the square footage calculation. For example, the Tower and Plaza buildings which house many of our executives and corporate overhead areas were built in 1903 and 1968, respectively. For the four fiscal yeas included in the audit, the only locations owned or leased subsequent to 1978 are as follows:

Facility	Owned	Date
Norcross Data Center	Owned	1981
Education Center	Leased	1984
Employee Health Club	Leased	1987
Direct Medicare - All	Leased	various
Medicare EDP Support	Leased	1986

Section X. B. 1. of Appendix B also states:

> "Additional amounts of space may be so allocated, provided that the contractor justifies such additional amounts."

d. Justification for Additional Space

The following justification is provided for the allocated square footage relative to the Norcross Data Center, the Travelers Education Center and the Travelers employee health club all of which were built or leased subsequent to 1978:

Norcross Data Center

The Travelers data center, located in Norcross, Georgia and built in 1981, has a total area of 136,833 square feet. The majority of the space is devoted to computer hardware such as mainframes and printers. Pre-pnnted check stock is stored on site. The data center also has a large mailroom for issuing all of the mailings that are generated. For Medicare, all Explanation of Medicare Benefits (EOMBs) and checks are printed and mailed from this location.

As part of our Part B contract, we maintain one of the remaining standard systems and have located the computer hardware necessary to comply with HCFA requirements in the Norcross Data Center. HCFA paid for the development of the system and has historically reimbursed us for the costs associated with maintenance, enhancements and operations. We process claims for our Part B, RRB - Part B and DMERC contracts at this location and, in addition, with HCFA approval, we are in a shared processing arrangement with Blue Cross and Blue Shield of Rhode Island to process their Part B claims. All mailings for our Part A contract are also processed at this facility.

In addition, HCFA has also contracted with us to operate one of the *nine* Common Working File (CWF) host sites. Our contract for the CWF host site in the Keystone Sector specifically requires us to provide computer hardware for both data" processing and data storage. (See Attachment 3 - Reference Article II. B. 1. a.)

For the years under audit the following square footage was allocated from this facility to Medicare:

Fiscal Year 1990	13,260
Fiscal Year 1991	16,472
Fiscal Year 1992	30,271
Fiscal Year 1993	30,023

Starting in fiscal year 1992, the Medicare allocation was changed to include specific machines and floor space that were dedicated to Medicare utilization resulting in the increase in square feet documented above.

The square footage associated with the Norcross data center is necessary to enable us to perform our contractual obligations as a standard system maintainer and a CWF Host site. It is, therefore, justified and should be excluded prospectively from the calculation of excess square footage.

Travelers Education Center

The five story Travelers Education Center, initially leased in 1984, should also be excluded from the calculation because it is justified and is specifically allowable per the Federal Acquisition Regulations, Section 31.205-44, (f) which states:

> "Maintenance expense and normal depreciation or fair rental on facilities owned or leased by the contractor for training purposes are allowable.. ."

The following square footage was allocated from this facility to Medicare:

Fiscal Year 1990	2,940
Fiscal Year 1991	951
Fiscal Year 1992	2,089
Fiscal Year 1993	3,918

The education center is a state of the art facility. Course offerings include management development programs, personal computer software training, data processing programming training and personal skills development training such as courses in communications, business writing and interpersonal skills. The facility is also used to hold conferences, seminars and meetings.

The Travelers Education Center, used extensively by Medicare for training of both Home Office and Field Office employees, is justified and allowable per the FAR. It should specifically be excluded prospectively from the calculation of excess square feet.

Employee Health Club

The Travelers Health Club, located in Hartford, is an underground exercise facility. Our allocable share of the square footage should be excluded because this facility is specifically allowed by our contracts. In our contracts, Appendix B., Section V., Employee Morale, Health, Welfare and Food Service Costs and Credits, it states:

> "Employee morale, health and welfare activities are those services or benefits provided by the contractor to its employees to improve working conditions, employee relations, employee morale, and employee performance."

In that same section, it further states:

> "The aggregate of costs incurred on account of all activities mentioned in paragraph A less income generated by all such activities, is allowable to the extent that the net amount is reasonable."

The following square footage was allocated from this facility to Medicare:

Fiscal Year 1990	1,066
Fiscal Year 1991	1,105
Fiscal Year 1992	955
Fiscal Year 1993	1,260

The facility not only provides exercise equipment including aswimming pool and a jogging track, but also holds seminars related to living healthier life-styles and stress reduction. Dues are charged to offset the cost of operations.

The allocated rent is justified and allowable per our contracts and should be excluded prospectively from the calculation of net usable square feet.

e. Recalculation of Audit Finding

Relative to <u>direct</u> Medicare space, our calculation of the excess square footage is included as Attachment 4. We did not exceed the 135 square feet requirement in any of the four fiscal years.

2. FOLLOW UP OF PRIOR AUDIT FINDINGS

The auditors recommended disallowance of costs that were claimed for allocated vacant space, tax planning costs, leased equipment costs and pension contributions. These issues were under dispute from the audit of fiscal years 1988 and 1989. While the draft audit report includes verbiage from the Dennis and Co. report, we would like to clarify that these costs were not audited during the current audit. We were requested to quantify the costs that were claimed during the four fiscal years and were informed that Tichenor & Associates could not render an opinion as to the allowability of these costs, but that these. cost issues would be decided based on the resolution of the fiscal years 1988 and 1989 dispute.

We recently reached a tentative settlement with HCFA on these four issues and propose that these costs in fiscal years 1990 through 1993 be resolved similarly. We support the decision made by HCFA related to the allowability of these costs. Each of the four items is addressed below:

A. Vacant Space

These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. **Our** reasoning is restated below:

Dennis and Company disallowed certain costs related to vacant space on the sole basis that FAR $31.205-17, "Idle Facilities and Idle Capacities Costs," provides that idle facilities costs are unallowable. However, the auditors failed to take into consideration the full language of FAR $31.205-17, which both makes exceptions to the rule on the unallowability of idle facilities costs, and clearly distinguishes idle facilities costs from idle capacity costs. Taking into consideration the fill language of this cost principle, Travelers' idle facilities and idle capacity costs are fully allowable.

FAR $31.205-17 distinguishes between idle facilities and idle capacity in the definitional section as follows:

"Idle facilities," as used in this subsection, means completely unused facilities that are excess to the contractor's current needs.

"Idle capacity," as used in this subsection, means the unused capacity of partially used facilities.

FAR §3 1.205-17(a), in pertinent part

FAR $31.205-17 further distinguishes between idle facilities and idle capacity costs in how it treats such costs for purposes of determining their allowability:

(b) The costs of idle facilities are unallowable unless the facilities --

(1) Are necessary to meet fluctuations in workload; or

(2) Were necessary when acquired and are now idle because of changes in requirements, production economies, reorganization, termination, or other causes which could not have been reasonably foreseen. (Costs of idle facilities are allowable for a reasonable period, ordinarily not to exceed 1 year, depending upon the initiative taken to use, lease, or dispose of the idle facilities (but see §3 1.205-42)).

(c) Costs of idle capacity are costs of doing business and are a factor in the normal fluctuations of usage or overhead rates from period to period. Such costs are allowable provided the capacity is necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire plant or among a group of assets having substantially the same function may be idle facilities.

FAR $31.205-17(b) and (c) (emphasis added). Thus, for purposes of determining the allowability of costs, the FAR permits the allowability of idle facilities costs when they are necessary to meet fluctuations in workload, or when they were necessary when acquired and are now idle because of reasonably unforeseen changes in requirements. FAR $31.205-17 also allows idle capacity costs provided the capacity is necessary or was originally reasonable and is not subject to reduction or elimination by subletting in accordance with sound business practices.

Travelers vacant space costs are allowable under these express cost allowability principles. The Travelers vacant space policy[7] is that rent is charged to the Vacant Space cost center when a "tenant" (a Travelers Department or unit) moves out of an area as a result of a Corporate "directive and in accord with the Master Space Plan (MSP). The MSP is designed to reduce the amount of leased space used in the Hartford area by placing key operating units in strategically selected owned buildings, and to reduce the use of leased space and maximize the use of company-owned buildings. The vacant space cost center is also used when tenants are moved to temporary space while their permanent location is renovated. The tenant is charged for the temporary space while the area under renovation is charged to vacant space. Thus, Travelers vacant space involves both idle capacity as well as idle facilities.

As can be seen from Travelers' vacant space policy, the vacant space charges relating to idle facilities arise from changed requirements, reorganization changes, production economies, and other causes, all of which factors Travelers takes into consideration under its MSP in assigning space. In addition, the vacant space charges arising from idle capacity are clearly the result of normal business fluctuations, not subject to reduction or elimination, such as when space is being renovated.

Accordingly, Travelers idle facilities and idle capacity costs are expressly allowable under FAR $31.205-17.

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7 Travelers set forth this policy and additional explanation on these costs in its May 30th, 1991 response to the draft audit report.

B. Leased Equipment

These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. Our reasoning is restated below:

The auditors disallowed certain of Travelers ADPE lease costs on the sole basis that the auditors were unable to determine that these costs benefited the Medicare program.

As set forth in some detail in Travelers May 30, 1991 response to the draft audit report for fiscal years 1988 and 1989, the ADP equipment is necessary for Travelers to fulfill its obligations under its Medicare contracts with the federal government. Thus, such costs are allowable.

More particularly, in mid-1988, Travelers chose to lease, rather than purchase, its ADP equipment needs. This option offered Travelers certain financial advantages.

When Travelers made lease payments to the lessor, Travelers booked the amortized equipment amount to the responsibility code which "manages" the equipment repayment. The costs are built into the charge rates of the Data Center, and are allocated to Medicare based on the usage of the DP cost centers. All product lines within the company are treated in a like manner as Medicare. Thus, Medicare bore its proportional share of an allowable and *necessary* business expense.

As such, a portion of the ADP lease costs are properly allocable to Medicare since the equipment is necessary to fulfill Medicare contractual obligations. Therefore, the ADP lease costs are also allowable under FAR $31.205-2, "Automatic Data Processing Equipment Leasing Costs. " Under that cost principle, ADPE lease costs are allowable if they: (1) are reasonable and necessary for the conduct of the contractor's business; (2) represent charges only for the current use of the equipment, and (3) do not cost the Government more than if the contractor had purchased the ADP equipment. Travelers ADPE lease costs meet each of these criteria. Thus, such costs are "allowable.

C. Tax Planning

These costs were deemed by HCFA to be allowable for fiscal years 1988 and 1989 and Travelers asserts that these costs should also be allowable for fiscal years 1990 through 1993 as well. Our reasoning is restated below:

By report of August 26, 1991, the auditors found that Travelers' Tax Planning Center costs were unallowable based on two theories: (1) that the costs were unallowable under FAR $31.205-27 which prohibits expenditures in connection with planning or executing the organization or reorganization of the corporate structure of a business including mergers and acquisitions; and (2) that the costs were unallowable because they were directly associated costs of unallowable Federal Income and excess profit taxes, FM $31.205-41.

Contrary to the auditors' position, Travelers Tax Planning Center costs are allowable costs. First, while the Tax Planning Center is occasionally involved in analyzing the tax consequences of the proposed acquisition or disposition of various business" segments or subsidiaries, its role does not extend to the "planning or execution of the organization or reorganization" of a business as described in FAR $31.205-27. Thus, the costs are not unallowable under FAR $31.205-27.

Second, the auditors incorrectly determined that the Tax Planning Center costs were unallowable because they were directly associated costs of unallowable Federal Income and excess profit taxes costs. The costs of preparing and submitting business tax forms are expressly allowable under FAR 331.205-28, which provides, in pertinent part:

> The following types of recurring costs are allowable when allocated on an equitable basis:
>
> (e) Preparing and submitting required reports and forms to taxing and *other* regulatory bodies.

(Emphasis added.) Thus, the Tax Planning Center costs associated with filing Federal Income tax forms are expressly allowable costs under FAR 331.205 -28..

D. Pension Contributions

We propose settling on the unqualified plan using the same methodology that was used to settle this issue for fiscal years 1988 and 1989. Ron Solomon, HCFA, OACT, in his memo dated April 28, 1994, recommended that, "Since ultimate payment of accrued, but not projected, benefits is secured by the amendments, the government will consider accrual costs for the value of only the accrued benefits as allocable and allowable contract costs without regard to finding. This recommendation is to apply to costs for all years beginning with fiscal year 1987, notwithstanding the fact that the FAR change was not effective until fiscal year 1990. "

For the four fiscal years, we claimed a total of $48,682 on our FACPS. The revaluation by our actuaries indicates that the total allowable cost for the 'period was $771,929. Therefore, we understated our costs by $723,247 for FY 90 through 93. These additional costs should be considered as part of the settlement for these years.

For your review, we have attached actuarial reports (See Attachment 5) setting forth the calculation of the accrual costs of the Plan, separately identifying the value of accrued benefits from the total (projected) benefit value for each year, accompanied by an analysis of how the costs are allocated to the Medicare contracts for each fiscal year.

3. UNDERSTATED CREDIT FOR COMPLEMENTARY INSURANCE

We agree with the auditors' findings related to the understatement of credits for complementary insurance amounting to $201,400 in the RRB FACP. This understatement was caused by a systems error that was discovered in October, 1994. The programming has been corrected and credits for complementary insurance have been properly accumulated and reported in subsequent periods.

4. UNALLOWABLE INDIRECT COSTS

A. COST CENTERS NOT BENEFITING MEDICARE

Actuarial Programs

We agree with the audit findings related to the disallowance of $31,956 of expenses incurred in the Actuarial Programs cost center.

Subsidiary Audit

We disagree with the recommended disallowance of $58,723 of expenses allocated from the cost center titled "Subsidiary Audit".

At one time, this cost center actually reflected expenses for internal audits of The Travelers subsidiaries. However, as Travelers divested itself of these business entities, the internal auditors assigned to this cost center acquired additional responsibilities. For the period under audit, expenses captured in this cost center resulted from a number of internal audit initiatives, one of which was the responsibility of auditing the Managed Care and Employee Benefits Organization. Medicare is a business unit in this organization.

The internal auditors assigned to this cost center did provide direct benefit to Medicare during fiscal years 1990 to 1993 and Medicare's allocable share of these expenses should be allowed. To document this benefit, an audit report, issued by Subsidiary Audit in fiscal year 1991 for our Part B office in Bloomington, Minnesota is attached (See Attachment 6). The report is addressed to Richard Stuart who, at that time, was the Vice President in charge of Medicare.

Corporate Actuarial

We disagree with the recommended disallowance of $93,188 of expenses incurred by our corporate actuaries.

The auditors cite the FAR 531.201-4 which states, in part, "A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received...". In addition, they reference the Medicare contract, Appendix B, Section XV, paragraph A.3. which states, :The following items are unallowable:... A...(3) costs relating to the contractor's underwriting activities, including actuarial related services... "

However, the cost center in question included the corporate pension actuaries who have responsibility for valuing the qualified and non-qualified pension plans for The Travelers and performing the segmentation valuation for Medicare as well as identifying and allocating pension assets to the Medicare segment. These activities are specifically required in the Medicare contract, Appendix B, Section XVI, paragraphs C and D which state:

> ".. the contractor shall separately calculate pension costs for a Medicare Segment... "

> ". ..the contractor must separately identify pension assets for any Medicare Segment(s) . . .

These functions were performed as required on an annual basis since fiscal year 1988.

In addition to the annual valuation process, the pension actuaries also had significant involvement in the Office of the Inspector General (OIG) audit of The Travelers qualified pension plan for fiscal years 1988 through 1990 that was conducted in" fiscal year 1993. They provided documentation to the OIG actuary and were instrumental in ensuring the successful completion of that audit. Reference Review of Unfunded Pension Costs of The Travelers Insurance Company, CIN: A-07-93 -O0665, and Audit of Medicare Contractor's Pension Segmentation The Travelers Insurance Company, CIN: A-07-93-00634.

We maintain the costs of the corporate actuaries are allowable, and that Medicare should bear its allocable share of the total cost.

B. CLAIMED COSTS UNALLOWED BY FAR

We agree with the audit findings related to Treasury Administration (cost center 112-04-100), Executive (cost center 121-0 1-000) and General Corporate (cost center 142-02-100). During the fiscal years under audit, personnel in these departments spent varying amounts of time related to selling subsidiaries, merging and/or acquiring companies and raising capital.

C. BUDGETED RATHER THAN ACTUAL COSTS

We agree with the auditor's finding related to capturing budgeted expenses in the Corporate and Staff cost center instead of actual costs. We have incorporated this adjustment in future period costs.

D. NO SUPPORTING DOCUMENTATION

We agree with the audit findings

E. OVERLOOKED ELIMINATING COST CENTERS

We agree with the audit findings and have eliminated the cost centers in question from future period(s) costs.

5. UNDERSTATED RETURN ON INVESTMENT

We agree with the auditors' findings related to the understated return on investment on Medicare assets of $15,365. The error was of a one-time nature and should not reoccur in future periods.

OTHER MATTERS

1. FOLLOW-UP ON PRIOR AUDIT REPORT FINDINGS

The auditors have documented that we have continued to claim costs relative to the four audit findings from the prior audit report for all four fiscal years. While this is correct for our Parts A and B contracts, the situation is somewhat different for our RRB contract.

The RRB contract was put out to bid during fiscal year 1992 by the Railroad Retirement Board. In the process of submitting our proposal, we had correspondence with the Board that documented the disputed costs and indicated that these costs would be excluded from our cost reporting until such time as the Armed Services Board of Contract Appeals ruled that these costs are allowable. In compliance with this agreement dated May 22, 1992 (See Attachment 7) we have excluded these costs from our fiscal year 1993 Final Administrative Cost Proposal as well as for all subsequent periods.

In the tentative settlement reached with HCFA for fiscal years 1988 and 1989, these costs were deemed to be allowable except for the unqualified pension plan for which a portion of the costs were agreed to be allowable. For fiscal year 1993, we would like to establish that the following costs were excluded from the FACP for the RRB contract:

COST CENTER	COST EXCLUDED
Pension Contributions	$ 0
Tax Planning Expense	$1,789
EDP Lease Expense	$70,414
Vacant Space Expense	$26,452
Total Excluded	$98,655

The exclusion of these costs is clearly documented on the worksheet provided to the auditors summarizing the disputed costs claimed during fiscal years 1990 through 1993. The expenses shown in the table above should be included as part of the settlement for these years.

2. INCENTIVE PAYMENTS

The auditors have recommended that for fiscal years 1992 and 1993, incentive payments should not be received for reductions in costs due to unallowable costs disclosed by the audit for our Parts A and B contracts. We disagree with this recommendation because the target cost for incentive purposes is not necessarily based on approved finding for budget purposes.

The process associated with negotiating a finding level for the upcoming fiscal year is separate from the process of negotiating a target cost for incentive purposes and two different branches within HCFA are responsible for responding to and settling on each proposal. The verbiage contained in the incentive contracts clearly documents the intent on the part of both HCFA and The Travelers to calculate incentive payments using the agreed upon target and audited, allowable costs.

The incentive contract for Part B for fiscal year 1992 contained the following statement:

> "Upon receipt of the Final Administrative Cost Proposal (Form HCFA-1 524), for Fiscal Year 1992, the Secretary shall determine if an incentive payment is due the Carrier. Calculations regarding incentive payments due the Carrier will be based on the Fiscal Year 1992 Final Administrative Cost Proposal, as submitted, subject to audit and adjustment, if appropriate."

The fiscal year 1993 incentive contract for Part B stated the following:

> "Final determination of the administrative costs of, and the incentive payment payable to the Carrier shall be undertaken by the Secretary and the Carrier as rapidly as possible after the Secretary's receipt of the Carrier's final statement. A closing agreement between the Carrier and the Secretary with respect to those items of administrative costs which they agree are allowable and the amount of the incentive payment shall be incorporated in a memorandum.. ."

In addition, Article XXXII of the fiscal year 1993 Part B contract entitled "Incentive Payment" states:

> "If the total amount of actual allowable costs for Fiscal Year 1993, as reported in column F of the Final Administrative Cost Proposal (Form HCFA-1 524), minus allowable costs for the functions listed above, is less than $43,316,900, the Secretary will share with the Carrier 50 percent of any amount which is less than $43,316,900..."

The verbiage included in the fiscal years 1992 and 1993 incentive contracts for our Part A contract mirrors that documented above.

In the case of the allowable costs discussed below that were submitted in revised Final Administrative Costs Proposals, we recalculated the associated incentive award and believe that the. award should be recalculated again for purposes of issuing a closing agreement once the results of this most recent audit are finalized.

3. REVISED FACPS

On September 29, 1993, we submitted revised FACPS for FY 1990 through 1992 to document additional, allowable costs related to taxes, the qualified pension plan, EDP Corporate planning and a spreadsheet down load problem. Tot al additional costs claimed for FY 1990 through 1992 totaled $2,611,673. The costs related to the qualified pension plan are documented by the OIG in the audit reports: Review of Unfunded Pension Costs of The Travelers Insurance Company, CIN: A-07-93-00665, and Audit of Medicare Contractor's Pension Segmentation The Travelers Insurance Company, CIN: A-07-93-00634. HCFA indicated that we could not draw these additional funds until all cost items had been audited to verify their allowability.

While the audit report does not reference these costs, we did have discussions with and provide supporting documentation to the auditors during their field work. Attached is a copy of a memo (See Attachment 8) that documents their opinion that these costs are allowable and applicable to the Medicare contracts. Note that the auditor's memo indicates that the costs submitted on the revised FACPs were in excess of the Notices of Budget Approval (NOBA) in *effect* at the time. Documentation supplied to them clearly indicated that we did not exceed the NOBA and this comment was therefore not included in these audit reports.

These additional expenses should be included as part of the settlement for these years.

INTERNAL CONTROLS

The audit report cited several internal control weaknesses to which Travelers management has the following responses:

- *Travelers does not have adequate quality assurance procedures for the payroll data being input into the Personnel Information Management System (PIMS) to assure that it has been approved by the responsible manager. The internal auditors have identified this issue since 1991...*

The Travelers management agrees with this internal audit finding and recently implemented the "PIMS Input Review Process" to address this weakness. Each month, a sample. of PIMS/Payroll transactions which have a financial result (new hires, terminations, increases, overtime, input of hourly time sheets, paid discretionary absences, etc . ...) will be randomly selected from PIMS. The Human Resource (HR) Council member is then responsible for ensuring that all transactions are verified for validity and proper approval based on the department's internal procedures. This will be accomplished either through obtaining and examining copies of the source document with proper approval signatures other than the input operator or by consultation with line area managersfsupervisors.

If satisfied that all transactions are valid and accurate, the HR Council member will sign-off on the Input-Review Completion Form and return it to Corporate Payroll. If unsatisfied that all transactions are valid and accurate, an explanation of the problem and resolution being taken should be detailed in the comments section of the Input-Review Completion Form. Payroll personnel will monitor the reports for compliance with the procedure.

- *Travelers does not have adequate procedures for assuring that reimbursable travel costs are adequately documented in accordance with established corporate policies and procedures.*

In response to this finding in the internal audit report, Travelers management indicated that Travel Services would send out communication emphasizing Corporate guidelines for travel and entertainment expenses and supporting documentation on a quarterly basis.

We would like to note that the auditors did not come across this issue during their review of travel documents.

- *Travelers does not periodically inventory assets such as furniture and equipment to assure their physical existence is reconciled to their recorded accountability for same.*

While the Travelers does not perform company-wide periodic inventories of assets, we have been working for some time on improving the accuracy of the asset listings maintained on the Fixed Asset Inventory and Depreciation System (FAIDS). We believe that we have sufficient alternate procedures in place to ensure that FAIDS assets are materially correct. These procedures are as follows:

> In a series of teleconferences, Corporate Facilities and Finance reviewed asset listings from FAIDS with assets on site for each of The Travelers' larger locations. FAIDS was updated as required.
>
> The Corporate Tax Department, when filing property tax returns, performs reasonableness checks for each location involved by comparing the Furniture and Equipment with the number of people. Inventones are performed at those sites which fall outside established parameters.
>
> For any large moves or reorganizations, a physical inventory is conducted and a designated employee is responsible for submitting information necessary to update FAIDS.
>
> Furniture and equipment held in the warehouse that is available to be recycled is tracked on the Material Resource and Recovery system (MRR). There is an automated feed from this system to FAIDS so that movements in and out of the warehouse are properly recorded and accounted for.

We believe the procedures outlined above allow us to cost-effectively account for furniture and equipment.

In addition, we would like to highlight that Medicare does perform an annual inventory of its assets in compliance with HCFA requirements.

- *Travelers does not have adequate procedures to identify and segregate unallowable costs.*

On a monthly basis, we verify and analyze the Corporate cost centers that are allocated to Medicare. While the dollar value of the unallowable costs documented in this audit report with which we agree is relatively small in relation to our total administrative budget, we concur that our controls need to be fine tuned.

We have been working with an outside consultant to improve upon our cost accounting procedures in order to ensure that only allowable costs are reported to the government.

- *Time sheets were not consistently signed by the employees and in some cases time sheets were missing.*

The Corporate Payroll Handbook specifies the record retention policy for time sheets as seven (7) years. In April, 1995, a new form was implemented for recording the hours worked by hourly paid employees. It parallels the form already in use for non-exempt employees; a single sheet for several employees maintained in the unit. The hours worked during the day are filled in by the employee and then the employee signs the form at the end of each week. The department payroll representative collects these forms at the end of the week, verifies that all of the required signatures are present and that the hours are filled out properly, then stores the forms in a file to meet the 7 year record retention requirement;

We are aware that, occasionally, employees may forget to sign the forms and that, due to office closings, department reorganizations, and changes in department payroll representatives there can be problems in insuring that the record retention policy is carried out to the fullest extent. To reinforce the necessity of ensuring that legal requirements related to employee payroll records are followed, Corporate Payroll will periodically publicize the importance of following these procedures in its newsletter which is issued at regular intervals throughout the year.

- *Pay rates used for cost allocation purposes did not consistently agree to the personnel files due to timing differences in updating files.*

Based on the documentation provided to us by the auditors, Travelers disagrees that the two situations that were the basis of the above comment represent break downs in our controls.

In one instance, the employee was paid based on an annualized salary of $21,945. The auditor noted that this salary did not agree to the "pure" rate of $20,900 on the personnel file which also documents a "pay" rate of $21,945. The pure rate documents the annual salary. The actual pay rate is the annual rate at which an employee is compensated. For the vast majority of salaried Travelers employees, these rates are the same. However, the employee selected works in the systems operations area. Because her normal workdays include Saturdays and Sundays, she is paid a shift differential, in this case, $1,045 annually. This employee was paid correctly in accordance with Travelers policies.

In the second situation, an hourly employee was given a pay increase effective 6/15/90 which was a Friday. For the pay period ended 6/22/90, she was paid at the old rate. Hourly employees are paid a week in arrears such that the paycheck of 6/22/90 is for hours worked the week ended 6/14/90 (prior to 1995, the hours worked for hourly employees were accumulated from Friday through the following Thursday). The new rate should not have been and was not used to pay this employee until the next pay period.

Both of these situations were handled correctly by The Travelers payroll system and we maintain that the auditors' comment is erroneous.

1

ATTACHMENT 1

The Travelers
Government Operations
Facilities Costs
FY84-86

	1984	1985	1986
Total Facilities Cost (Per FACP)			
Part A	505,037	639,413	699,287
Part B	1,286,424	1,469,491	1,500,336
Part RRB	1,232,997	1,430,307	1,313,773
Total	3,024,458	3,539,211	3,513,396
Less: Direct Facility Costs			
Part A	262,888	288,449	363,184
Part B	694,850	700,787	763,245
RRB	721,445	751,110	680,968
Total Field	**1,679,183**	**1,740,346**	**1,807,397**
Net Indirect Facilities Costs	1,345,275	1,798,865	1,705,999
Corporate Equivalent Rent/Square Foot	$16.17	$17.78	$19.56
Indirect Usable Sq. Ft.	83,221	101,202	87,241
Usable Sq Ft Factor	80?40	80%	80%
Indirect Net Usable Sq Ft	66,577	80,962	69,793
Direct Net Usable Sq Ft	122,585	131,304	118,167
Total Net Usable Sq Ft Sq. Ft.	189,162	212,266	187,960
Equivalent Man Years	1,108.0	1,175.0	1,061.0
Avg Net Usable Sq Ft	171	181	177
Allowable Sq Ft	135	135	135
Excess Sq Ft	36	46	42
% **Excess vs** Allowable	26.46%	33.82%	31 .22?40
Direct and Indirect Faciliti	3,024,458	3,539,211	3,513,396
Overcharge to HCFA	*800,338*	*1,196,818*	*1,097,051*

The Travelers
Government Operations
Equivalent Man Years
FY *84-86*

		NPH	Net Available Hours	Equivalent Man Years
FY 1984	Part A	217,441	1,577	137.9
	Part B	769,439	1,599	481.2
	RRB	747,517	1,599	467.5
	Total			1,086.6
	Plus: Temps, Govt., etc.			21.7
	Total Equiv. Man Years			1,108.3
FY 1985	Part A	211,743	1,585	133.6
	Part B	821,147	1,605	511.6
	RRB	812,945	1,604	506.8
	Total			1,152.0
	Plus: Temps, Govt., etc.			23.0
	Total Equiv. Man Years			1,175.1
FY 1986	Part A	180,659	1,583	114.1
	Part B	751,064	1,610	466.5
	RRB	738,980	1,609	459.3
	Total			1,039.9
	Plus: Temps, Govt., etc.			20.8
	Total Equiv. Man Years			1,060.7

ATTACHMENT 2

1250. EXHIBIT OF FACILITIES AND OCCUPANCY SCHEDULE, FORM HCFA-3259.

FACILITIES AND OCCUPANCY SCHEDULE
Hospital/Supplementary Medical Insurance Benefits Program

Contractor (Name and Address)	Identification No.	Fiscal Year

Medicare Allocation

	Base Period (Indicate Period)	Budget $
A. Depreciation and Rent or Lease		
1. Depreciation		
2. Rent or Lease		
B. Power, Heat and Light		
C. Other Costs (Excluding ROI)		
TOTAL 1/	$	$
D. Return on Investment 2/	$	$

Cost Per Square Foot:

	Total Cost Base	Total Cost Budget	Square Feet Base	Square Feet Budget	Cost Per Sq. Foot Base	Cost Per Sq. Foot Budget
Gross		$			$	$
Usable						
Net Usable						

Identify the percentage of this cost included in each line item.

Line	%	Line	%	Line	%

Does the space charge include labor and related costs for:

	Yes	No	If no, what line item
(1) maintenance			
(2) janitorial			
(3) utilities (heat, power, Light)			
(4) security			
(5) real property taxes			
(6) insurance			
(7) other - identify			

Describe the allocation method(s) used to distribute facilities and occupancy costs to Medicare. Is the same allocation method used for all lines of business? Yes No
If no, explain.

1. Should agree with the Facilities and Occupancy line of Cost Classification Report.

1

ATTACHMENT 3

DEPARTMENT OF HEALTH AND HUMAN SERVICES
HEALTH CARE FINANCING ADMINISTRATION

AMENDMENT OF CONTRACT
HEALTH CARE FINANCING ADMINISTRATION

CONTRACTORS NAME AND ADDRESS	CONTRACT NUMBER	AMENDMENT NUMBER
The Travelers Insurance Company One Tower Square Hartford, Connecticut 06183	HCFA 87-301-2	5
	CONTRACT DATE	**EFFECTIVE DATE OF AMENDMENT**
	October 1, 1987	July 24, 1989

THE ABOVE MENTIONED CONTRACT IS HEREBY AMENDED AS FOLLOWS:

1. Add the following new article to Section 1:

ARTICLE XXXII
Common Working File Host

WHEREAS, The Travelers Insurance Company (referred to hereinafter as 'The Carrier") agrees to operate as a CWF host site for HCFA in the Keystone Sector, and

WHEREAS, HCFA has agreed, subject to the following terms and conditions, to finance the operation of CWF by The Carrier as a host site.

NOW THEREFORE, the parties do hereby agree as follows:

I. DEFINITIONS

A. "HCFA" means the Health Care Financing Administration, an agency of the Department of Health and Human Services.

B. "CWF" means a decentralized Medicare Part A and Part B claims validation and benefit authorization process. This HCFA initiative is designed to simplify and improve Medicare claims processing by creating a series of host sites, each servicing a network of satellite sites within a defined Sector.

C. "Host Site" means a localized data base system under contract with HCFA to maintain beneficiary specific files containing complete entitlement, utilization, and history data. All Medicare Part A and Part B claims will be processed against this single file.

D. "Satellite Site and User" both mean a Medicare contractor, within a host site's sector, which processes Medicare claims.

E. "Sector" means a geographically defined area of the United States within which all satellite sites are dependent upon the same host site.

F. "Keystone Sector" means the States of Delaware, New Jersey and Pennsylvania.

G. "Production Support" means the activities required of CWF systems staff in order to keep the CWF system functioning properly in a production environment. This includes, but is not limited to: incorporating any HCFA software changes and updates, including emergency updates, into the host's CWF software; resolving system problems; and responding to satellite inquiries.

H. "Conversion/Installation Support" means the providing of support for satellite additions in the host's sector and for new host sites, as specified by HCFA, and for the extraction and conversion of appropriate beneficiary paid claims history from the satellite's system to meet CWF requirement.

I. "PSR" means Proposal Submission Requirements Common Working File Host issued on November 22, 1988.

3. "FAR" means Federal Acquisition Regulations.

II. <u>SCOPE OF WORK</u>

The Carrier agrees to perform the following work:

A. That which is set forth in Section 3 of the PSR and in The Carrier's Proposal to perform as Host to the Common Working File in the Keystone Sector, both of which are hereby incorporated by reference.

The Carrier agrees to perform the following work:

B. Common Working File Production/User Support

1. The Carrier shall provide the support required to ensure normal day-to-day operations of the CWF system. This support shall include, but is not limited to:

   a. Providing computer hardware for both data processing and data storage;
   b. Providing operational staff support;
   c. Providing technical staff support; and
   d. Providing telecommunication support for HCFA access to the CWF data base, as well as the normal flow of data between the HCFA batch master and the CWF system.

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Avg Net Usable Sq Ft	171	181	177
Allowable Sq Ft	135	135	135
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% Excess vs Allowable	26.46%	33.82%	31.22%
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Equivalent Man Years
FY 84-86

		NPH	Net Available Hours	Equivalent Man Years
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	RRB	747,517	1,599	467.5
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	RRB	738,980	1,609	459.3
	Total			1,039.9
	Plus: Temps, Govt., etc.			20.8
	Total Equiv. Man Years			1,060.7

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FACILITIES AND OCCUPANCY SCHEDULE
Hospital/Supplementary Medical Insurance Benefits Program

Contractor (Name and Address)	Identification No.	Fiscal Year

Medicare Allocation

	Base Period (Indicate Period)	Budget $
A. Depreciation and Rent or Lease		
1. Depreciation		
2. Rent or Lease		
B. Power, Heat and Light		
C. Other Costs (Excluding ROI)		
TOTAL 1/	$	$
D. Return on Investment 2/	$	$

Cost Per Square Foot:	Total Cost Base	Total Cost Budget	Square Feet Base	Square Feet Budget	Cost Per Sq. Foot Base	Cost Per Sq. Foot Budget
Gross		$			$	$
Usable						
Net Usable						

Identify the percentage of this cost included in each line item.

Line	%	Line	%	Line	%

Does the space charge include labor and related costs for:

	Yes	No	If no, what line item
(1) maintenance			
(2) janitorial			
(3) utilities (heat, power, light)			
(4) security			
(5) real property taxes			
(6) insurance			
(7) other - identify			

Describe the allocation method(s) used to distribute facilities and occupancy costs to Medicare. Is the same allocation method used for all lines of business? Yes_ No_
If no, explain.

1. Should agree with the Facilities and Occupancy line of Cost Classification Report.

ATTACHMENT 3

DEPARTMENT OF HEALTH ANo HUMAN SERVICES
HEALTH CARE FINANCING ADMINISTRATION

AMENDMENT OF CONTRACT
HEALTH CARE FINANCING ADMINISTRAI iON

CONTRACTOR'S NAME AND ADDRESS	CONTRACT NUMBER	AMENDMENT NUMBER
The Travelers Insurance Company One Tower Square Hartford, Connecticut 06183	HCFA 87-301-2	5
	CONTRACT OATE	EFFECTIVE DATE OF AMENDMENT
	October 1, 1987	July 24, 1989

THE ABOVE MENTIONED CONTRACT IS HEREBY AMENDED AS FOLLOWS:

1. Add the following new article to Section I:

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Common Working File Host

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WHEREAS, HCFA has agreed, subject to the following terms and conditions, to finance the operation of CWF by The Carrier as a host site.

NOW THEREFORE, the parties do hereby agree as follows:

I. DEFINITIONS

A. "HCFA" means the Health Care Financing Administration, an agency of the Department of Health and Human Services.

B. "CWF" means a decentralized Medicare Part A and Part B claims validation and benefit authorization process. This HCFA initiative is designed to simplify and improve Medicare claims processing by creating a series of host sites, each servicing a network of satellite sites within a defined Sector.

C. "Host Site" means a localized data base system under contract with HCFA to maintain beneficiary specific files containing complete entitlement, utilization, and history data. All Medicare Part A and Part B claims will be processed against this single file.

D. "Satellite Site and User" both mean a Medicare contractor, within a host site's sector, which processes Medicare claims.

E. "Sector" means a geographically defined area of the United States within which all satellite sites are dependent upon the same host site.

F. "Keystone Sector" means the States of Delaware, New Jersey and Pennsylvania.

G. "Production Support" means the activities required of CWF systems staff in order to keep the CWF system functioning properly in a production environment. This includes, but is not limited to: incorporating any HCFA software changes and updates, including emergency updates, into the host's CWF software; resolving system problems; and responding to satellite inquiries.

H. "Conversion/Installation Support" means the providing of support for satellite additions in the host's sector and for new host sites, as specified by HCFA, and for the extraction and conversion of appropriate beneficiary paid claims history from the satellite's system to meet CWF requirement.

I. "PSR" means Proposal Submission Requirements Common Working File Host issued on November 22, 1988.

J. "FAR" means Federal Acquisition Regulations.

II. SCOPE OF WORK

The Carrier agrees to perform the following work:

A. That which is set forth in Section 3 of the PSR and in The Carrier's Proposal to perform as Host to the Common Working File in the Keystone Sector, both of which are hereby incorporated by reference.

The Carrier agrees to perform the following work:

B. Common Working File Production/User Support

1. The Carrier shall provide the support required to ensure normal day-to-day operations of the CWF system. This support shall include, but is not limited to:

a. Providing computer hardware for both data processing and data storage;
b. Providing operational staff support;
c. Providing technical staff support; and
d. Providing telecommunication support for HCFA access to the CWF data base, as well as the normal flow of data between the HCFA batch master and the CWF system.

2. The Carrier shall provide the support necessary for the normal day-to-day operations interface between the CWF user and HCFA. This support includes, but is not limited to:

   a. Providing telecommunications support for satellites in its sector;
   b. Providing the support required to maintain day-to-day liason activities with CWF users;
   c. Providing telephone and/or onsite assistance, as necessary, to respond to and correct CWF-related problems that may occur;
   d. Monitoring CWF user data flow and volume statistics;
   e. Providing reports of user activity to the HCFA CWF Project Officer, who shall be designated by HCFA in a separate written notification to the contractor, and to the HCFA Regional Office; and

3. The Carrier shall provide the support required to respond to, and. correct, problems that may occur in the course of normal system operations.

4. The Carrier shall provide the support required to monitor all production processing, production reports, and other aspects of system processing as appropriate.

5. The Carrier shall provide the support required to receive and install updates/upgrades to the CWF system software.

6. The Carrier shall provide system processing reports to the HCFA CWF Project Officer.

7. The Carrier shall provide ongoing cost expenditure reports and personnel utilization reports, as well as projected expenditure reports, to the HCFA CWF Project Officer and to the HCFA Regional Office.

8. The Carrier shall provide the support required to secure, install, maintain, upgrade, and monitor user-to-CWF site communications facilities.

C. Common Working File Conversion/Installation Support

With HCFA assistance and guidance, The Carrier shall provide the support required to assist with the installation of additional CWF user satellite sites to be designated by HCFA. This support includes, but is not limited to:

a. Providing technical guidance for telecommunication operations between the host and its satellites;
b. Providing system, program, implementation, and installation documentation as appropriate;
c. Providing telephone and/or onsite assistance as necessary for installation, testing, and implementation; and

D. The Carrier shall provide such other services as shall reasonably be required by HCFA.

III. Payment

A. Payment shall be made in accordance with Section 1.17 of the PSR entitled "Payment for Administration of Contract", which is hereby incorporated by reference, and in accordance with the following summary of costs, proposed by The Carrier and agreed to by HCFA:

Summary of Costs

1.	IMPLEMENTATION PERIOD	
	July 24, 1989- September 21, 1989	$ 250,000
2.	OPERATIONAL PERIODS	
	a. September 22, 1989- September 30, 1989	$ 209,900
	b. October 1, 1989- September 30, 1990	$1,496,700
	c. October 1, 1990- September 30, 1991	$1,540,800
3.	TERMINATION COSTS (Contingent)	$ 41,000
4.	TOTAL OPERATIONAL COSTS (2a. Plus 2.b. plus 2.c.)	$3,247,400
5.	TOTAL CONTRACT COST (1+3+4)	$3,538,600

B. Adjustments in the agreed upon amount, as shown in Article 111. A., herein, will be made only for legislative changes or revised regulations and general instructions which significantly impact the administration of the host site function.

C. Upon notification of termination or nonrenewal of this amendment at any time by the Secretary, reasonable costs incurred by the contractor due to such termination which are directly related to the obligations of the contractor in carrying out the provisions of this amendment will be allowable, subject to audit, in accordance with the principles set forth in "Termination of Contract," of Medicare Contract No. HCFA 87-301-2 These costs will be paid subject to funding availability after review by HCFA to determine the reasonableness and allowability of costs claimed.

IV. TERM OF AMENDMENT

A. This amendment shall begin on July 24, 1989 and, except as provided for hereunder, this amendment shall end on September 30, 1991. It will automatically be renewed for successive periods of 1 year unless the Secretary or the contractor gives written notice of intention not to renew the amendment at least 90 days before the end of the current period. Such notice shall be sent no later than the 90th day.

B. The Secretary and the contractor shall have the right to nonrenew the work required by this amendment while renewing and continuing performance of Medicare Contract No. HCFA 87-301-2.

C. In the event that either the Secretary or the contractor gives notice of intent not to renew this amendment, the Secretary shall have the right to extend this amendment for an additional period not to exceed 180 days, as provided in paragraph B and C of Article XXVI, "Term of Contract, of Medicare Contract No. HCFA 87-301-2."

D. In the event that Medicare Contract No. HCFA 87-301-2 terminates or is nonrenewed prior to or concurrently with the end of any renewal period for this amendment, the term for performance of all work of this amendment shall end simultaneously with the effective termination or nonrenewal date of the Medicare contract.

V. Contract Provisions

This amendment hereby incorporates by reference section 1.21 of the PSR.

VI. Termination

This amendment hereby incorporates by reference section 1.21.3 of the PSR, pertaining to termination.

VII. Requirement for Certificate of Procurement Integrity - Modification (May 1989)

(A) Definitions. The definitions set forth in FAR 3.104-4 are hereby incorporated in this clause.

(B) The Contractor agrees that it will execute the certification set forth in paragraph (c) of this clause, when requested by the contracting officer in connection with the execution of any modification of this contract. A contract modification may not be executed without the certification.

(C) Certification. As required in paragraph (b) of this clause, the officer or employee responsible for the modification proposal shall execute the following certification:

CERTIFICATE OF PROCUREMENT INTEGRITY–MODIFICATION (MAY 1989)

(1) I, (Name of certifier) am the officer or employee responsible for the preparation of this modification proposal and hereby certify that, to the best of my knowledge and belief, with the exception of any information described in this certification, I have no information concerning a violation or possible violation of subsection 27(a), (b), (c), or (e) of the Office of Federal procurement Policy Act* (41 U.S.C. 423), (hereinafter referred to as the Act), as implemented in the FAR, occurring during the conduct of this procurement (contract and modification number).

(2) As required by subsection 27(d)(l)(B) of the Act, I further certify that each officer, employee, agent, representative, and consultant of (Name of offeror) who has participated personally and substantially in the preparation or submission of this proposal has certified that he or she is familiar with, and will comply with, the requirements of subsection 27(a), (b), (c), or (e) of the Act, as implemented in the FAR, pertaining to this procurement.

(3) Violations or possible violations: (Continue on plain bond paper if necessary and label Certificate of Procurement Integrity--Modification (Continuation Sheet), ENTER "NONE" IF NONE

{Signature of the Officer or Employee Responsible for the Modification Proposal and date)

(Typed Name of the Officer or Employee Responsible for the Modification Proposal)

* Section 27 became effective on July 16, 1989.

THIS "CERTIFICATION CONCERNS A MATTER WITHIN THE JURISDICTION OF AN AGENCY OF THE UNITED STATES AND THE MAKING OF A FALSE, FICTITIOUS, OR FRAUDULENT CERTIFICATION MAY RENDER THE MAKER SUBJECT TO PROSECUTE UNDER TITLE 18, UNITED STATES CODE, SECTION 1001.

(End of certification)

(D) In making the certification in paragraph (2) of the certificate, the Contractor may rely upon the certification by an officer, employee, agent, representative, or consultant that such person is in compliance with the requirements of subsections 27(a), (b), (c), or (e) of the Office of Federal Procurement Policy Act (41 U.S.C. 423), as implemented in the FAR, unless the Contractor knows, or should have known, of reasons to the contrary. The Contractor may rely upon periodic certifications that must be obtained at least annually, supplemented with periodic training programs. These certifications shall be maintained by the Contractor for a period of 6 years from the date of execution.

(E) The certification required by paragraph (c) of this clause is a material representation of fact upon which reliance will be placed in executing this modification.

This amendment shall have no effect on any other terms, clauses, or conditions of the aforementioned contract.

Funds Certified Available for fiscal year 1989 only.

Barry J Tucker 9-7-89
(DATE)

Director
Division of Contractor Financial Management, OFO

Accepted by:

The Travelers Insurance Company

By: Richard S Stuart
(Signature)

Richard S. Stuart
(Name)

Second Vice President
(Title)

September 1, 1989
(Date)

ATTACHMENT 4

1

The Travelers
Medicare
Excess Space Calculation

Description	1990	1991	1992	1993
Allocated Square Feet				
Direct Medicare	**158,383**	**152,662**	145,959	**145,959**
FTEs				
Direct Medicare	**1,319**	**1,189**	1,100	**1,086**
Sq. Foot per FTE	120	**128**	133	**134**
Allowable	135	135	135	135
Excess per FTE	**(14.9)**	**(6.6)**	**(2.3)**	**(0.6)**
Total Excess Sq. Ft.	**o**	**0**	**0**	**0**

ATTACHMENT 5

Coopers & Lybrand

Coopers & Lybrand L.L.P.
a professional services firm

Human Resource Advisory

July 6, 1995

PRIVATE AND CONFIDENTIAL

Ms. Margaret Christophy
Chief Financial Officer
MetraHealth Insurance Company
99 East River Drive - 5RS
East Hartford, CT 06108

Re: Rests-cnt of Costs For Nonqualified Pension Plan for 1991 through 1993

Dear Maggie:

This letter serves as a revised actuarial report for the Travelers non-qualified pension costs for 1990 through 1993 as they pertain to government operations employees.

We performed this valuational the request of the Travelers in order to determine nonqualified pension costs under CAS 412 and 413 for the Medicare segment, using a revised calculation method that considers only benefits accrued to date. These costs were determined for the purpose of Government reimbursement under the Cost Accounting Standards. and are not appropriate for FAS 87 accounting or IRS funding purposes

A summary of the results is shown below. along with the costs for 1987 through 1989 developed earlier:

	Total Plan CAS Cost (with Interest)	Total Plan Benefit Pymts.	Medicare Part of CAS Cost	Amount Already Charged to HCFA
1988	$1,732,070	$362.074	543.197	
1989	1,732,070	484,469	62.6:0	
1990	5,787,151	881,000	159,476	$569,057
1991	15,895,034	1,499,619	383,547	(217,620)
1992	5,399,104	2,032,499	139.534	(434,944)
1993	3,170.207	4,368,335	89.372	132,189

Ms. Margaret Christophy
MetraHealth
July 6.1995
Page 2

Details on the assumptions and methodology are in Exhibit I

Details on the Medicare reserve are in Exhibit II.

Details of the valuation results arc in Exhibit III.

Please call me with any question...

Respectfully Submitted,

COOPERS & LYBRAND L.L.P.

Fred C Lindgren

Fred C. Lindgren, FSA, MAAA
Enrolled Actuary No. 93-3677

FL:rg
Attachments (exhibits)
cc: Judy Latta

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Exhibit I - Assumptions and Methods

General Methodology: We followed the methodology described in Ron Solomon's memo to Jeffrey Robbins. We started with our prior restatement of costs for the years 1987 through 1989 and extended it to 1993. Costs were calculated on a calendar year basis.

Source of Data: These calculations were based on a variety of workpapers provided by the Travelers. These workpapers were originally developed for financial accounting purposes (FAS 87) and thus do not tie into the amounts previously claimed. We did not check or recalculate liabilities from employee data. The sources of data for 1990, 1991, and 1992 were workpapers from Travelers' own calculation of FAS 87 disclosures. The data for 1993 came from a Towers Perrin valuation report dated June, 1994. Travelers provided additional information on one-time charges for FAS 87 purposes.

Reserve Accumulation: We calculated the accumulated value of the reserve, representing amounts reimbursed but not yet paid to participants. We started with zero as of January 1. 1987. This **was:**

- increased each year with reimbursable amounts,
- decreased with actual benefit payments, and
- increased with interest at the valuation rate.

Allocation of Costs: The cost of the entire plan is allocated over **payroll.** The direct/indirect split was provided by Travelers.

Plan Amendments and Changes in Assumptions and Methods: The liabilities of the plan were affected by various plan amendments and assumption changes. These changes in liabilities were amortized over 10 years, consistent with our calculations for 1987 through 1989. Gains or losses due to settlements and curtailments were treated as regular gains or losses, and amotized over 15 years. Special benefits offered as part of an early retirement window were treated as a regular plan amendment and amortized over 10 years.

Severance Pay: It appears that severance pay passed through this plan In 1990, 1991. and 1992. Normally, this would have been reimbursed in the year paid, and would have been excluded from the pension calculation We have shown the amounts below; you might want to check to see whether this was accounted for as a severance cost. We did not include these amounts as a pension cost.

1990	$571,913
1991	$445,302
1992	$167,501

Exhibit I - Assumptions and Methods (continued)

1995 Revisions to CAS Rules:
The 1995 revisions to CAS 412 and 413 will not affect these calculations because they come into effect in the year following publication. . If this plan is continued beyond 1995. the new rules will require funding in order to continue recovery on an accrual basis.

Actuarial Assumptions:
Details of the actuarial assumptions can be found in the valuation reports for the Pension Plan for Salaried Employees of the Travelers Insurance Corporation and Certain of Its Subsidiary'~s. A few kcy assumptions are listed below:

Actuarial Cost Method	Pure Unit Credit
Asset Smoothing	None
Discount Rate	8.5% from 1987 to 1991, 8.25% for 1992, and 8.0'% for 1993
Mortality	GA-51 (male) projected to 197$. Five year setback for females Changed in 1992 to 1983 Group Annuity Mortality for Males. six year setback for females.
Salary Increase	0.0%. We expect these participants to have salary increases in the future. but we understand that the benefits based on future increases are not considered to be "compellable" at this time.

Exhibit II
Travelers Insurance Company
Nonqualified Supplemental Pension Plan
Reserve Reconciliation 1987 1993

	1987	1988	1989	1990	1991	1992	1993
Interest Rate	8.50%	8.50%	8.50%	8.50%	8.50%	8 [illegible]%	8.00%
Reserve at Beginning of Year	0	1,513 261	2,995 214	4,475,102	9.721,074	24,873.'35	30 :'21.596
Contributions/Allocations	1,732.0/1)	1.732,070	1.732,070	5.707.151	15.895,034	5,399,'04	3 170.W7
Benefits Paid	(209.1 78)	(362,074)	(484 469)	(861 ,000)	(1 ,499,619)	(2,032, 499)	(4 368.335)
Earnings	(9,631)	111957	232287	339,821	757,246	1.961 .256	2 744.756
Expenses/Credits	(1	0	0	Q	0	0	0
Participant Transfers In (Out)	0	0	0	0	0	0	0
Reserve at End of Year	1,513,261	2,9%.214	4,475102	9,721 .074	24,873,735	30.201 596	31.46.224

Unfunded Liability

	1987	1988	1989	1990	1991	1992	1993
Reserve at Beginning of Year	.1	1,513,261	2.9%.214	4,475,102	0.721,074	24,873.735	30.,"1)1.596
Liability at Beginning of Year	9,993,881	10.833.477	11 .5S4.503	23,7S0,035	33.323.5S3	37.64181 O"	40 "-23.033
Unfunded to be Reimbursed							
• " Liability - Reserve	9,993,881	9320.216	8, S89.209	19,314,933	23.602,489	12,768 075	10 121 .437

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Coopers & Lybrand LLP

07/06/95

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Exhibit III
Travelers Insurance Company
Nonqualified Supplemental PensIon Plan
Details of the Valuation Results

	1987	1988	1989	1990	1991	1992	1993
EXPERIENCE ANALYSIS							
Unit Credit Unfunded AL, Beginning Prior Year		9,993.881	9,320.216	8.689,289	19,314,933	23,602.489	12,768,075
Unit Credit Normal Cost, Prior Year		192.558	t 9?.558	192,558	"2324,850	10.83':.633	l.272.801
Interest to End of Year		865.847	508.585	746.457	1.839.382	2,927 410	1,240,872
Contribution as of End of Prior Year		(1 732<0?0)	(1.?3? 0701	(1,732,070)	(5,787,151)	(15,89.034)	(5 399.104)
Expected UAL, Beginning of Year		9.320.216	8.589.289	7.796,234	17,692,014	21.472.499	1-/882,644
Actual UAL, Beginning of Year	9,993<891	9,320.216	8,S89 289	19.314.933	23,602,489	12.760.07s	10 12.1.437
Total Loss (Gain)		0	0	1.518.699	5,910.475	(8,70 4.423)	(761,207)
- Plan Change		0	C	11,081,237	4,994,810	(5,891,614)	269,327
- Assumption Change		0	G	0	0	1.67! .141	916.389
- Total Plan/Assumpt		0	0	1.061237	4.894.810	(4,020 473)	1,185,716
Experience Lose		0	0	437.462	915.665	(4.6.s 4,950)	1 946,923)

CAS AMORTIZATION SCHEDULE

	1987	1988	1989	1990	1991	1992	1993
Unamortized Balances							
Initial Unfunded 1987	9,993,881	9,320.216	6,S392W	7.796,234	6,935,769	6,00.:.166	4,'384.14s
Gain/Loss 1960		0	0	0	0	0	0
Plan change 1988		0	0	0	0	0	0
Gain/Loss 1989			(1	0	0	0	0
Plan Change 1989			0	0	0	0	0
Gain/Loss 1s90				437,462	421,967	40.,155	386.61 3
Plan change 1990				11,081,237	10,334.277	9.52X824	9.636.497
Gain/Loss 1991					91s.665	88.1231	847,404
Plan change 1991					4.994,810	4,654,121	4,268,975
Gain/Loss 1992						(4,6a 4,950)	14,s14.771)
Plan/Assumpt Change 1982						(4,020,473)	. 3,746.220]
Gain/Loss 1993							:1,946,923)
Plan/Assumpt Change 1993							1 185.716
Gain/Loss 1994							
PlenfAssmp4Chanae1994							
Net Unamortized, Beginning of Year	9.993,881	9.320.216	8,S89 289	19.314,%?3	23,602,488	12,7[$074	10.121.436
Unfunded Act Liab. Beginning of Year	9,993,881	9,320.216	8.589,289	19,314.933	23,602,489	12,7('.8.075	10,121.437
Amortization Payments (Credits)							
Initial Unfunded 1987 over 10 years	1,403.0:'0	1,403,820	1403,820	1,403,820	1.403.819	1,397,875	1.393,349
Gain/Loss 1968 over 15 years		0	0	0	0	0	0
Plan Change 1988 over 10 years		0	0	0	0	0	0
Gain/Loss 1969 ovor 15 years			v	0	0	0	0
Plan Change 19S9 over 10 years			0	0	0	0	0
Gain/Loss 1990 over 15 years				48,552	48,552	48,007	47.501
Plan change 1990 over 10 years				1,556,658	1,556559	1,545,536	1 .539.s56
Gain/Loss 1991 over 15 years					101,627	100,410	9S,273
Plan Change 1991 over 10 years					701.611	696,019	691.060
Gain/Loss 1992 over 15 years						(511.261)	(507.053)
Plan/Assumpt Change 1992 over 10 years						(559,762)	(555,272)
Gain/Loss 1993 over 15 years							,210,609)
Plan/Assumpt Change 1993 over 10 yearn							163,617
&lln/Leas 1994 over 15 yews							
Plan/Assumpt Change 1994 over 10 years							
Amortization Payment	1.403 820	1.403 820	1 403 820	3,008.930	3,812,168	2,7:4824	2,657,812

Coopers & Lybrand UP 07/06/95

Exhibit III
Travelers Insurance Company
Nonqualified Supplemental Pens(on Plan
Details of the Valuation Results

	198:	1988	1989	1990	1991	18 92	1993
VALUATION RESULTS							
Interest	8.50%	8 50%	8 50%	8.50%	8.50%	8 25%	8.00%
Unit Credit Act Liab	9,993,86	10.833.477	11,584,503	23,790,035	33.33553	37.64 1 810	40.323.033
Actuarial Reserve	0	1 .s13.261	2.995.X4	4.475.102	9.721.074	24.873735	10 201,596
Unit Credit UAL	9,993.86 I	9.320.?16	8.s89 289	19,314,933	23,602,489	12,768 075	121.437
Unit Credit Normal Cost	192,558	192,558	192,558	2.32'4.650	10,837,633	2.27>801	217.565
Amortization Payment	1,403,8?1:	I 403,820	1,403.820	1,008,930	3,812.163	2,714 824	2.657,812
CAS Par-lam Cost	1.596.3 78	1,596,378	1,596,378	5.s33,780	14,649.801	4.987625	7.935.377
Interest to End of Year	135,692	135,692	135,692	453.371	1 ,24.s.233	411479	234,830
CASFundIn91 argot	1,732,070	1,732,070	1,732,070	5.787.151	15,8%,034	5,399104	170.207
GOVERNMENT OPERATIONS SHARE							
Allocate based on total payroll							
Direct		1 7984%	2 7383%	1 .0923%	1 .6660%	1.8068%	1 9491?4
Indirect		O 6955%	o 8776%	0.7634%	0.7470%	0.7776%	0 8703%
Total		2 4939%	3 6159%	2.7557%	2.4130?4	2.5844%	28191%
Govt Opers Dollars							
Total Plan Cost x Sham							
Direct		31,150	47,429	115.297	264.811	97,551	61.701
Indirect		12,047	15,201	44,179	118,736	41,983	27,581
Total Annual Cost		43,197	62.630	159,476	383,547	139,534	89,372
Govt Opers Actual Payments							
Total Distributions x Share							
Direct		16.512)	(13,260)	(17,552)	(24,984)	(36,723)	(8s,143)
Indirect		[2,518)	(4,252)	(6,726)	(11,202)	(15,805)	(38,005)
Total Distributions		[9.030)	(17,518)	(24.278)	(36.186)	(52,528)	,123.148)
Excess of Allocated Cost over Allocated Distributions							
Direct		24,638	34,163	97,745	239,827	60,828	[23.352)
Indirect		9,529	10.94'3	37,453	107.534	26.178	(10,424)
Total Distributions		34 167	45,112	135.198	347.261	87,006	(33,776)

ATTACHMENT 6

The Travelers

Audit Department

December 6, 1990

Richard Stuart, Vice president
Managed Care and Employee Benefits Operations

Audit of the Bloomington, Minnesota Medicare Claim Office

We have completed an audit of the Bloomington, Minnesota Medicare Claim Office. This office processes Medicare Part B claims under Contract with the U.S. government under the office of the Health Care Financing Administration (HCFA). Bloomington administers Medicare Part B for eleven southeastern Minnesota counties. During the first eight months of 1990, approximately 1.8 million claims, totalling $ 211 million were processed at the Bloomington office.

We had obtained an understanding of the Medicare claim processing procedures in the Meriden, Connecticut office. Our review in Bloomington was designed to verify that the procedures and controls previously identified in Meriden were operating as intended. We evaluated procedures over such items as backlog, pended claims, quality assurance, returned and refunded checks, and beneficiary service. In addition, our review included testing a limited sample of paid claims.

The results of our audit were favorable. We concluded that procedures and controls were in place to provide reasonable assurance that paid claims were properly supported and processed in a timely and accurate manner in accordance with federal regulations. Pended claims were monitored and resolved in a timely manner, and returned and refunded checks were properly processed.

HCFA reviews the procedures and results of all Medicare offices on a continuous basis through the Contractor Performance Evaluation Program (CPEP) and issues to each an annual evaluation report. In its most recent CPEP report for the year ended September 30, 1989, the Bloomington office received an overall efficiency rating of 96%, which ranks it eighth out of 49 Medicare offices.

We rate the Bloomington Medicare Claim Operations 3-A.

Maureen C. Williams

Maureen C. Williams
Director
Subsidiary Audit

cc: E.H. Budd
T.O. Thorsen
P.W. Glover

S90-19

ATTACHMENT 7

TheTravelers

MANAGED CARE AND
EMPLOYEE BENEFITS Operations

Richard S. Stuart
Vice President
Government Programs

The Travelers Companies
One Tower Square
Hartford, CT 06183
Telephone: 203 277-2478

May 22, 3992

Mr. Howard J. Nagle
U. S. Railroad Retirement Board
Purchasing Division - Room 1230
844 North Rush Street
Chicago, IL 60611

Dear Mr. Nagle:

Per our telephone conversation of today, we are removing from the costs contained in our Railroad Medicare Proposal, those items identified in the January 30, 1991 audit performed by Daniel Dennis & Company.

The nonqualified pension expense issue is currently under appeal to the Armed Services Board of Contract Appeals. If the Board rules that these costs are allowable, we will at that time reinstate them as part of our regular expenses. If the Board decides these costs to be inappropriate, they will be permanently excluded from our costs.

The costs noted in the audit, and excluded from the costs in our proposal, axe listed below:

Pension Contributions	$109,000
Unallowable Tax Planning Expense	$ 4,000
Unallocable Lease Expense	$96,000
Unallowable Vacant Space Expense	none

We appreciate the opportunity to review the matter with you and your willingness to reach a mutually agreeable solution. If you have any further questions regarding our proposal, or any other issues with which I can be of service, please do not hesitate to contact me.

Sincerely,

Richard S Stuart

Richard S. Stuart

RSS:ss

ATTACHMENT 8

-/ ‘

October 27, 1994

TO: Margaret Christophy, CFO, Gov't. Ops., MCEBO, The Travelers Insurance Company

Ken Wachner

FROM : Kenneth Wachner, Tichenor & Associates, CPAs

Subject: Costs Claimed on FACPs Exceeds the NOBAs (See attached document.)

Travelers claimed costs on the FACPs for fiscal years 1990, 1991 and 1992 exceed the applicable NOBAs by over %2.5 million. While these costs are allowable and applicable to the Medicare contracts, costs in excess of the NOB(-3S are unallowable.

Tentative Finding: Travelers should reduce the fiscal year 1990, 1991 and 1992 FACP costs claimed by $2.S million. HCFA may want to use these monies to offset other unallowable costs contained in this report.

We would appreciate your comments regarding this tentative finding. This finding will definitely be included in the report though its exact form may undergo some change.

For the purpose of documenting the timely disclosure of potential findings, I acknowledge receipt of this correspondence.

Margaret Christophy (Date)