

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**NATIONAL HERITAGE INSURANCE  
COMPANY  
CHICO, CALIFORNIA**

**AUDIT OF MEDICARE FINAL  
ADMINISTRATIVE COST PROPOSALS  
FOR THE PERIOD OCTOBER 1, 1998  
THROUGH SEPTEMBER 30, 2000**



**JANET REHNQUIST  
Inspector General**

**JANUARY 2002  
CIN: A-09-01-00088**

# *Office of Inspector General*

<http://www.oig.hhs.gov>

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The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

## *Office of Audit Services*

The OIG's Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others.

Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the Department.

## *Office of Evaluation and Inspections*

The OIG's Office of Evaluation and Inspections (OEI) conducts short-term management and program evaluations (called inspections) that focus on issues of concern to the Department, the Congress, and the public. The findings and recommendations contained in the inspections reports generate rapid, accurate, and up-to-date information on the efficiency, vulnerability, and effectiveness of departmental programs.

## *Office of Investigations*

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## *Office of Counsel to the Inspector General*

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. The OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within the Department. The OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops model compliance plans, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.



Region IX  
Office of Audit Services  
50 United Nations Plaza  
San Francisco, CA 94102

CIN: A-09-01-00088  
January 9, 2002

Trace Woodward  
Chief Financial Officer  
National Heritage Insurance Company  
402 Otterson Drive  
Chico, CA 95928

Dear Mr. Woodward:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General, Office of Audit Services' (OAS) report entitled "National Heritage Company Audit of Medicare Final Administrative Cost Proposals for the Period October 1, 1998 through September 30, 2000." Should you have any questions or comments concerning the matters commented on in this report, please direct them to the HHS official named below.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), OIG, OAS reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.) As such, within 10 business days after the final report is issued, it will be posted to the World Wide Web at <http://oig.hhs.gov/>.

To facilitate identification, please refer to Common Identification Number A-09-01-00088 in all correspondence relating to this report.

Sincerely,

A handwritten signature in black ink, appearing to read "Lori A. Ahlstrand".

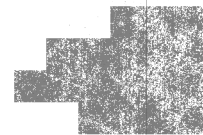
Lori A. Ahlstrand  
Regional Inspector General  
for Audit Services

Enclosures – as stated

Direct Reply to HHS Action Official:

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**



**NATIONAL HERITAGE INSURANCE  
COMPANY  
CHICO, CALIFORNIA**

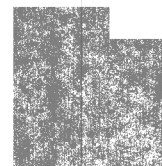
**AUDIT OF MEDICARE FINAL  
ADMINISTRATIVE COST PROPOSALS  
FOR THE PERIOD OCTOBER 1, 1998  
THROUGH SEPTEMBER 30, 2000**

*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, represents the findings and opinions of the HHS/OIG Office of Audit Services. Final determination of these matters will be made by authorized officials.*



**JANET REHNQUIST  
Inspector General**

**JANUARY 2002  
CIN: A-09-01-00088**





Region IX  
Office of Audit Services  
50 United Nations Plaza  
San Francisco, CA 94102

CIN: A-09-01-00088

January 9, 2002

Trace Woodward  
Chief Financial Officer  
National Heritage Insurance Company  
402 Otterson Drive  
Chico, CA 95928

Dear Mr. Woodward:

The purpose of this report is to provide National Heritage Insurance Company (NHIC) with the results of our audit of administrative costs. The primary purpose of the audit was to express an opinion as to whether NHIC's final administrative cost proposals (FACP) for the period October 1, 1998 through September 30, 2000 presented fairly the allowable costs of administration of the Medicare program in conformity with the reimbursement principles contained in the Federal Acquisition Regulations (FAR).

We have concluded that \$118,199,816 of the \$128,100,962 claimed under the contract is acceptable. The balance of \$9,901,146 represents costs set aside for pension costs (\$801,140), home office indirect costs (\$8,568,685), return on investment (\$73,729), and the amount budgeted for forward funding (\$457,592).

In written response to our report, NHIC concurred with our findings. The NHIC's comments are included in their entirety as an APPENDIX to this report.

## INTRODUCTION

### BACKGROUND

The Medicare program is a Federal health insurance program whose beneficiaries include persons 65 years of age or over, disabled or blind persons, or those suffering from chronic renal disorders. Medicare was established by Congress in 1965 through the enactment of Title XVIII of the Social Security Act. Medicare consists of two distinct parts. Hospital Insurance (Part A) covers expenses of medical services furnished in an institutional setting, such as a hospital or a skilled nursing facility, or provided by a home health agency. Supplemental Medical Insurance (Part B) covers physician services, certain other medical equipment and services, and other outpatient services.

The Medicare program is administered by the Centers for Medicare & Medicaid Services (CMS), which contracted with NHIC to receive, review, audit and pay Medicare Part B

claims. The NHIC is entitled to reimbursement for the allowable administrative costs incurred, up to the contract ceiling, in carrying out its responsibilities under the program.

The administrative costs reported by NHIC for processing claims totaled \$128,100,962 for the period October 1, 1998 through September 30, 2000.

## **SCOPE OF AUDIT**

Our audit was performed in accordance with generally accepted government auditing standards. The primary purpose of the audit was to express an opinion as to whether NHIC's final administrative cost proposals for the period October 1, 1998 through September 30, 2000 presented fairly the allowable costs of administration of the Medicare program in conformity with the reimbursement principles contained in the FAR.

Pension and home office indirect cost allocations for general and administrative (G&A) costs as well as return of investment costs (ROI) claimed by NHIC and included in the FACP's were excluded from the scope of our audit. The Office of the Inspector General will perform a separate audit to determine the allowability of the pension costs claimed in accordance with the FAR, Title 48, Chapter 1, Part 21.205-6(j) and Cost Accounting Standards 412 and 413. Indirect cost rates used by NHIC are subject to audit by the Defense Contract Audit Agency (DCAA) and any changes to the rates used and those finally approved by DCAA could result in further adjustments to the FACP costs as claimed.

In planning and performing our audit, we considered the internal control structure in order to determine our auditing procedures. This evaluation was for the purpose of expressing an opinion on the FACP's and not to provide assurance on the internal control structure.

The management of NHIC is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of an internal control structure. 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. Inherent limitations in any 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.

The period covered by our audit was October 1, 1998 through September 30, 2000. The audit field work was conducted at NHIC's Chico, California office in September 2001.

## RESULTS OF AUDIT

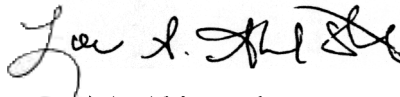
We have concluded that \$118,199,816 of the \$128,100,962 claimed under the contract is acceptable. The balance of \$9,901,146 represents costs set aside for pension costs (\$801,140), home office indirect costs (\$8,568,685), return on investment (\$73,729), and the amount budgeted for forward funding (\$457,592).

Pension costs are set aside pending a separate audit by the Office of Inspector General, Office of Audit Services, Region VII. Home office indirect costs and return on investment are set aside pending an audit by DCAA.

The \$457,592 for forward funding represents the amount budgeted by CMS for NHIC's transition to be the Medicare contractor in Southern California in FY 2001. We do not express an opinion on the amount budgeted.

NHIC concurred with our findings. NHIC's response is included in its entirety as Appendix A.

Sincerely,

A handwritten signature in black ink, appearing to read "Lori A. Ahlstrand". The signature is fluid and cursive, with a large initial "L" and "A".

Lori A. Ahlstrand  
Regional Inspector General  
for Audit Services

**NATIONAL HERITAGE INSURANCE COMPANY  
CHICO, CALIFORNIA  
SUMMARY OF RESULTS OF AUDIT  
OF MEDICARE ADMINISTRATIVE COSTS  
FOR THE PERIOD  
OCTOBER 1, 1998 THROUGH SEPTEMBER 30, 1999**

<u>Category of Cost</u>	<u>Total Proposed</u>	<u>Costs Set Aside</u>	<u>Notes</u>
Salaries and wages	\$22,514,995	\$2,099,675	1
Fringe benefits	5,480,599	904,068	2
Facilities or occupancy	2,946,463	275,368	1
EDP equipment	385,345	34,947	1
Subcontracts	20,446,914	0	
Outside professional services	420,299	39,594	1
Telephone and telegraph	1,095,987	100,310	1
Postage and express mail	7,742,709	718,810	1
Furniture and equipment	3,141,458	304,049	1
Materials and supplies	995,601	89,905	1
Travel	602,378	55,152	1
Return on investment	29,431	29,431	3
Miscellaneous	2,325,161	208,904	1
Credits	<u>(8,159,349)</u>	<u>0</u>	
 Total	 <u>\$59,967,991</u>	 <u>\$4,860,213</u>	



**NOTES TO SCHEDULE 1**

**Note 1.** The costs represent home office indirect costs, which we set aside pending a review by DCAA.

**Note 2.** The \$904,068 represents home office indirect costs of \$505,082, which we set aside pending a DCAA review, and pension costs of \$398,986, which will be audited separately by our Region VII office.

**Note 3.** The \$29,341 represents return on investment costs, which we set aside pending a review by DCAA.

**NATIONAL HERITAGE INSURANCE COMPANY  
CHICO, CALIFORNIA  
SUMMARY OF RESULTS OF AUDIT  
OF MEDICARE ADMINISTRATIVE COSTS  
FOR THE PERIOD  
OCTOBER 1, 1999 THROUGH SEPTEMBER 30, 2000**

<u>Category of Cost</u>	<u>Total Proposed</u>	<u>Costs Set Aside</u>	<u>Notes</u>
Salaries and wages	\$26,445,136	\$2,534,760	1
Fringe benefits	5,700,096	949,088	2
Facilities or occupancy	3,519,197	338,757	1
EDP equipment	933,714	90,658	1
Subcontracts	33,406,287	0	
Outside professional services	513,531	49,680	1
Telephone and telegraph	1,500,951	144,121	1
Postage and express mail	846,313	82,315	1
Furniture and equipment	513,473	50,469	1
Materials and supplies	1,537,348	147,940	1
Travel	1,116,651	109,389	1
Return on investment	44,298	44,298	3
Miscellaneous	432,554	41,866	1
Credits	(8,834,170)	0	
Forward funding	<u>457,592</u>	<u>457,592</u>	4
<b>Total</b>	<u><b>\$68,132,971</b></u>	<u><b>\$5,040,933</b></u>	

**NOTES TO SCHEDULE 2**

**Note 1.** The costs represent home office indirect costs, which we have set aside pending a review by DCAA.

**Note 2.** The \$949,088 represents home office indirect costs of \$546,934, which we set aside pending a DCAA review, and pension costs of \$402,154, which will be audited separately by our Region VII office.

**Note 3.** The \$44,298 represents return on investment costs, which we set aside pending a review by DCAA.

**Note 4.** The \$457,592 for forward funding represents the amount budgeted by CMS for NHIC's transition to be the Medicare contractor in Southern California in FY 2001. We do not express an opinion on the amount budgeted.

**APPENDIX A**  
**AUDITEE'S RESPONSE**



December 19, 2001

Centers for Medicare & Medicaid Services  
Lori A. Ahlstrand, Regional Inspector General  
Region IX  
Office of Audit Services  
50 United Nations Plaza  
San Francisco, CA 94102

Common Identification Number  
A-09-01-00088

Dear Ms. Ahlstrand:

We have received and reviewed the U.S. Department of Health and Human Services, Office of the Inspector General, Office of Audit Services, National Heritage Insurance Company draft report, entitled "Audit of Medicare Final Administrative Cost Proposals for the Period October 1, 1998 through September 30, 2000."

We concur with the results, schedules and notes to Schedules 1 and 2.

Should you have any further questions or concerns, I can be reached at (530) 896-7108.

Sincerely,

Trace Woodward  
Chief Financial Officer  
Medicare Administrative Services

cc: Sharon Burgess, CMS  
Diane Teakle, CMS  
Kirk Sadur, CMS  
Jeff Broocks, NHIC  
Anne Bockhoff Dalton, NHIC



**NHIC**