



SEP 17 1996

Memorandum

Date June Gibbs Brown
From Inspector General

Subject Audit of Administrative Costs Incurred Under Parts A and B of the Medicare Program -
Arkansas Blue Cross Blue Shield (A-06-96-00008)

To Bruce C. Vladeck
Administrator
Health Care Financing Administration

This memorandum is to alert you to the issuance on September 18, 1996 of our final report. A copy is attached.

This report presents the results of the certified public accounting firm of Doshi & Associates' audit of costs claimed on Arkansas Blue Cross Blue Shield's (ABCBS) final administrative cost proposals (FACP). The audit covered Medicare Parts A and B of the Arkansas program and Part B of the Louisiana program for fiscal years 1989 through 1994. 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 \$1,442,193 because ABCBS:

- o understated the complimentary credits from its private insurance business due Medicare by \$834,586. These credits arise from medical information contained in the Medicare claim and used in processing a claim from the private line of business;
- o did not credit Medicare with \$118,373 for its share of interest earned on an Health Maintenance Organization reserve balance for employee health insurance;
- o charged Medicare \$67,648 for funding a general contingency reserve for a Preferred Provider Organization as part of its employee health insurance plan. Such contingencies are unallowable per the Federal Acquisition Regulations;
- o allocated \$228,396 in excess executive compensation costs to Medicare during fiscal years 1991 through 1994. ABCBS increased its executive compensation an average of 34 percent for the period as compared to the Bureau of Labor Statistics' average increase of 14 percent for the same period;

- o allocated other miscellaneous unallowable costs totaling \$58,762 to Medicare. These included bank account fees - \$27,469, annual reports - \$23,885, legal fees - \$3,690, State licenses for insurance sales agents - \$1,844, telephone line charges - \$1,344, and social activities - \$530.

In order to avoid exceeding approved budgets, ABCBS did not claim \$5,121,476 in incurred Medicare costs for fiscal years 1993 and 1994. We offset a portion of the unclaimed costs against questioned costs. We made the offset because ABCBS had originally claimed the detailed costs on its FACP's, and then eliminated them because they exceeded budget ceilings. As a result, the unclaimed costs were identifiable and auditable. We did not, however, offset the remainder of unclaimed costs against questioned costs because they were not specifically identified.

In its response, ABCBS agreed with \$1,213,797 of the questioned costs, and disagreed with the findings on employee health insurance and executive compensation costs.

For further information, contact:

Donald L. Dille
Regional Inspector General
for Audit Services, Region VI
(214) 767-8415

Attachment



Beverly Villines
Director, Corporate Accounting
Arkansas Blue Cross Blue Shield
601 Gaines P.O. Box 8084
Little Rock, Ar 72203-2181

Dear Ms. Villines:

Enclosed for your information and use are two copies of an audit report (CIN: A-06-96-0008) prepared by Doshi & Associates, on behalf of the Department of Health and Human Services (HHS), Office of Inspector General (OIG), Office of Audit Services (OAS). The report covers the audit of administrative costs claimed by Arkansas Blue Cross and Blue Shield (ABCBS) for Parts A and B of the Arkansas Medicare Program and Part B of the Louisiana Medicare Program.

The audit report states that the audit was performed in accordance with generally accepted government auditing standards. The audit covered the Final Administrative Cost Proposals (FACP's) of ABCBS for the period October 1, 1988 through September 30, 1994. During the period audited, ABCBS claimed \$26,601,716 for administering the Arkansas Part A program, \$61,278,285 for administering the Arkansas Part B program and \$86,966,584 for administering the Louisiana Part B program. The audit report recommended adjustments totaling \$1,442,193. A description of the recommended adjustments follows:

Complimentary Insurance Credit - The report states that in four of the six years covered by audit, ABCBS understated the complimentary credits due Medicare. The recommended financial adjustments total \$834,586.

Employee Health Insurance - The report states that ABCBS offered its employees several health insurance plans including two groups: a Health Maintenance Organization (HMO) and a Preferred Provider Organization (PPO). The audit report stated that ABCBS overcharged Medicare for these two plans for the following:

Interest Earned on HMO Reserve Balance - ABCBS did not credit Medicare with \$118,373 for its share of interest earned on the HMO Reserve Balance.

PPO Coverage - The PPO insurance premium calculation included a risk factor to ensure payment of an enrollee's unpaid provider charges and to fund a general

contingency reserve. Since contingencies are unallowable per the Federal Acquisition Regulations (FAR) 31.205.7, a total of \$67,648 was questioned.

Executive Compensation Costs - ABCBS allocated \$228,396 in unreasonable compensation increases to Medicare during fiscal years 1991 through 1994. ABCBS increased its executive compensation an average of 34 percent for the period as compared to the Bureau of Labor Statistics' average increase of 14 percent for the same period.

Personal Use of Corporate Autos - ABCBS did not credit Medicare with \$134,428 which was due the program for employee's personal use of corporate autos.

Other Unallowable Costs - Other unallowable costs allocated to Medicare included: Bank account fees - \$27,469; annual reports - \$23,885; legal fees - \$3,690; State licenses for insurance sales agents - \$1,844; pollor line charges - \$1,344; and social activities \$530; for a total of \$58,762.

In order to avoid exceeding approved budgets, ABCBS did not claim \$5,121,476 in incurred Medicare costs for fiscal years 1993 and 1994. We offset a portion of the unclaimed costs against questioned executive compensation costs. We made the offset because ABCBS had originally claimed the detailed costs on the FACP's, and then backed them out because they exceeded budget ceilings. As a result, the unclaimed costs were identifiable. We did not, however, offset the remainder of unclaimed costs against questioned costs because they were not specifically identified.

In addition to the above recommended adjustments, the report also noted that ABCBS accumulated a \$4.5 million reserve balance in its HMO health insurance plan for employees. This was an experience rated plan, and represented an amount adequate to cover about 2 years of claims. We consider that amount to be excessive, and are recommending that HCFA evaluate the reasonableness of the reserve balance. Additionally, ABCBS did not retain all detailed documentation to support some expenses claimed, such as return on investment and certain data used in allocation tables. We are recommending that ABCBS establish the necessary procedures to ensure that all costs claimed are fully supported.

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

In accordance with the principles of the freedom of information Act (Public Law 90-23), OIG, OAS reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act, which the Department chooses to exercise. (See 45 Code of Federal Regulations, Part 5.)

Page 3 - Beverly Villines

To facilitate identification, please refer to Common Identification Number A-06-96-00008 in all correspondence relating to this report.

Sincerely yours,

A handwritten signature in black ink that reads "Donald L. Dille". The signature is written in a cursive style with a large initial "D".

DONALD L. DILLE
Regional Inspector General
for Audit Services

Enclosure - as stated

Direct Reply To:

Julia Kennedy
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Health Care Financing Administration
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Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF
ADMINISTRATIVE COSTS INCURRED UNDER
PARTS A AND B OF THE MEDICARE PROGRAM -
ARKANSAS BLUE CROSS BLUE SHIELD**



JUNE GIBBS BROWN
Inspector General

SEPTEMBER 1996
A-06-96-00008

SUMMARY

The Arkansas Blue Cross and Blue Shield, and Arkansas-Louisiana Blue Shield (Auditee) claimed administrative costs for Medicare Part A and B as follows:

<u>Fiscal Year</u>	<u>Arkansas</u>		<u>Louisiana</u>	<u>Total</u>
	<u>Part A</u>	<u>Part B</u>	<u>L.A. Part B</u>	
1994	\$ 4,867,499	\$ 10,240,929	\$ 14,613,107	\$ 29,721,535
1993	5,545,453	10,584,127	15,855,891	31,985,471
1992	4,392,779	11,689,417	15,912,028	31,994,224
1991	4,311,854	11,545,664	14,689,912	30,547,430
1990	3,800,133	8,901,771	13,599,700	26,301,604
1989	3,683,998	8,316,377	12,295,946	24,296,321
Total	<u>\$26,601,716</u>	<u>\$61,278,285</u>	<u>\$86,966,584</u>	<u>\$174,846,585</u>

Of the \$174,846,585 in administrative costs claimed by the Auditee during the six fiscal periods, we are recommending a financial adjustment of \$1,442,193. The remaining \$173,404,392 is recommended for acceptance.

Our findings and recommendations are summarized in paragraphs that follow:

Complimentary Insurance Credit - In four of the six years covered by audit, the Auditee understated the complimentary credits due Medicare. We are recommending the Auditee adjust its FACP's for the four fiscal years by a total of \$834,586.

Employee Health Insurance - The Auditee offered its employees several health insurance plans including two groups: a Health Maintenance Organization (HMO) and a Preferred Provider Organization (PPO). Our review of these two plans showed that the Auditee overcharged Medicare \$186,021 for the following:

- (a) **HMO Reserve Balance** - The Auditee had accumulated a \$4.5 million reserve balance in the experienced rated plan. A comparison of the plan's adjusted income to expenses for 1993 and 1994 showed the reserve amount would be adequate to cover about 2 years of claims expenses. In our opinion, this reserve amount may be unreasonable. We intend to recommend that HCFA evaluate the reserve amount to determine if the balance is reasonable, and to pursue recovery of Medicare's share of any amounts determined excessive.
- (b) **Interest Earned on HMO Reserve Balance** - The Auditee had not credited Medicare with its share of interest earned on the HMO reserve balance in accordance with FAR 31.205.5. Also, our review of the premium calculation showed the Auditee had not considered interest earned in establishing the premium rates. We are recommending the Auditee credit Medicare with a total of \$118,373 for its share of interest earned.
- (c) **PPO Coverage** - The PPO insurance premium calculation included a risk factor to ensure payment of an enrollee's unpaid provider charges and to fund a general contingency reserve for all Cost Plus Groups. Contingencies are unallowable per FAR 31.205.7. A total of \$67,648 is cost questioned related to the contingency factor.

Executive Compensation Costs - The Auditee allocated \$228,396 in unreasonable compensation increases to Medicare during the period fiscal years 1991 through 1994. The Auditee had increased its executive's compensation an average of 34 percent for the period as compared to the Bureau of Labor Statistics' average increase of 14 percent for the same period.

Personal Use of Corporate Auto - The Auditee had failed to give full credit to Medicare for employee's personal use of corporate autos. Additional credits of \$134,428 are due Medicare.

Unallowable Costs - We found a total of \$58,762 in other unallowable expenses that were allocated to Medicare.

<u>Expense</u>	<u>Amount</u>
Bank Account Fee	\$27,469
Annual Reports	23,885
Legal Fees	3,690
State License - Insurance Agents	1,844
Pollor Line Charges	1,344
Social Activities	530
TOTAL	<u>\$58,762</u>

Most of the these type expenses had been questioned by either HCFA or OIG in prior reports.

Retention of Supporting Documentation - The Auditee did not retain all detailed documentation to support some expenses it claimed, such as, ROI and certain data used in allocation tables. We will recommend the Auditee establish the necessary procedures to ensure that all costs claimed are fully supported.

The Auditee had not claimed all Medicare costs for fiscal years 1993 and 1994. A summary of unclaimed costs are as follows:

<u>Fiscal Year</u>	<u>Arkansas</u>		<u>Louisiana</u>
	<u>Part A</u>	<u>Part B</u>	<u>Part B</u>
1994	\$ 287,419	\$ 1,088,096	\$ 1,113,873
1993	308,923	1,091,690	1,231,475

Initially, these costs were recorded and allocated to Medicare. However, the Auditee eliminated the above amounts to avoid exceeding the approved budgets. We included all Medicare recorded costs in our audit coverage. However, except for executive compensation costs, we did not offset any of the above amounts against costs questioned.

The Auditee has agreed to \$1,213,797 of our recommended financial adjustments. Except for our findings related to Employee Health Insurance and Executive Compensation, the Auditee agrees with the findings and recommendations. In addition Auditee Officials have requested that excess Complimentary Insurance crossover credits for 1992 and unclaimed overhead costs for 1993 and 1994 be offset against recommended financial adjustments.

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INDEPENDENT AUDITOR'S REPORT OPINION

We have audited the "Final Administrative Cost Proposals" (FACP's) of Arkansas Blue Cross and Blue Shield for the fiscal years ended September 30, 1994, 1993, 1992, 1991, 1990 and 1989. These financial statements are the responsibility of Arkansas Blue Cross and Blue Shield management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted government auditing standards, "Government Auditing Standards," and the "Audit Guide for the Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers under Title XVIII of the Social Security Act" (Audit Instruction E-1), dated February 25, 1991. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We have identified a total of \$1,442,193 in costs recommended for financial adjustment. In addition, we have recommended HCFA evaluate the reasonableness of the \$4.5 million employee's health insurance reserve balance. The final determination as to whether such costs are allowable will be made by the United States Department of Health and Human Services.

Excluded from our audit was a review of pension segmentation. This exclusion was in accordance with the OIG audit guide. We were told that OIG is planning a separate audit of the Medicare intermediaries and carriers' pension plans for compliance with the segmentation provisions of the Federal Acquisition Regulations (FAR).

In our opinion, with the exception of the ultimate resolution of the costs recommended for financial adjustment, the FACP's referred to above present fairly, in all material respects, the administrative costs applicable to Part A and B Health Insurance for the Aged and Disabled Program, claimed by Arkansas Blue Cross and Blue Shield, for the period October 1, 1988 through September 30, 1994, in accordance with the reimbursement principles of Part 31 of the FAR as contained in 48 Code of Federal Regulations (CFR) Chapter (CH) 1, interpreted and modified by the Medicare Agreements.

Members

American Institute of Certified Public Accountants

Missouri Society of Certified Public Accountants

This report is intended solely for the use of management within Arkansas Blue Cross and Blue Shield and the Department of Health and Human Services and should not be used for any other purpose.

Kansas City, Missouri
February 8, 1995

Doshi & Associates P.C.
Doshi & Associates, P.C.

INTRODUCTION

BACKGROUND

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled Program (Medicare). Part A of the program provides insurance protection against the costs of hospital and related care. The Medicare Insurance Program, Part B - Supplementary Medical Insurance Benefits for the Aged and Disabled, is a voluntary program that provides protection against the cost of physicians' services and other health services not covered under Part A. The Medicare program is administered at the Federal level by the Health Care Financing Administration (HCFA), an agency of the Department of Health and Human Services.

Title XVIII provides that public or private organizations, known as Intermediaries for Part A and Carriers for Part B, may assist in the administration of the Medicare program. Part A Intermediaries are nominated by provider groups. Nominations are submitted to HCFA and agreements are entered into with approved Intermediaries. The Intermediaries receive funds to pay providers for the cost of service to eligible individuals and for the Intermediaries' administrative costs in operating the program. Carriers are reimbursed for all reasonable and allowable costs incurred in administering the Part B program.

Arkansas Blue Cross and Blue Shield (Auditee) serves as a Part A Intermediary and a Part B - Carrier. Benefit payments were made in the following amounts:

<u>Fiscal Year</u>	<u>Part A</u>	<u>Part B</u>	<u>LA Part B</u>
1994	\$842,514,133	\$330,729,739	\$585,645,792
1993	\$735,705,547	\$328,229,405	\$574,387,664
1992	\$681,825,421	\$326,781,057	\$553,917,398
1991	\$580,723,799	\$308,648,713	\$529,234,336
1990	\$596,324,206	\$285,047,411	\$489,856,922
1989	\$513,499,745	\$254,051,668	\$436,118,246

SCOPE OF AUDIT

Our examination was performed in accordance with generally accepted government auditing standards (Government Auditing Standards) and the "Audit Guide for Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers under Title XVIII of the Social Security Act" (Audit Instruction E-1), dated February 25, 1991. We examined the administrative costs claimed by the Auditee for the period October 1, 1988, through September 30, 1994, to the extent that we considered necessary to determine if amounts claimed were in accordance with applicable Federal requirements, policies and program instructions.

Our examination included audit procedures which were designed to achieve the following objectives:

Determine whether the Auditee has established effective systems of internal control, accounting and reporting for administrative costs incurred under the program.

Ascertain whether the FACP's present fairly the costs of program administration allowable in accordance with Part 31 of the FAR as interpreted and modified by the Medicare Agreements.

Ascertain whether the Auditee has complied with contractual and administrative requirements governing specific items of costs.

Identify the underlying causes of significant errors or problems noted and make recommendations for improvements or adjustment of costs claimed as appropriate.

Our audit procedures included examination of pertinent accounting records and supporting documentation.

Our audit excluded a review of pension segmentation. This area was excluded in accordance with the OIG audit guide. We were told the OIG is planning an audit of the Medicare intermediaries and carriers' pension plans for compliance with the segmentation provisions of FAR. Also, we did not evaluate the reasonableness of the Auditee's self-insured employee health insurance reserve fund.

The audit fieldwork was performed at the Arkansas Blue Cross and Blue Shield, offices in Little Rock, Arkansas, during the period November 26, 1994, through February 8, 1995.

FINDINGS AND RECOMMENDATIONS

COMPLIMENTARY INSURANCE CREDIT

During the six fiscal years covered by audit, the Auditee understated complimentary credits by a total of \$834,586. The understated amounts resulted from the improper calculation of the credit and a mathematical error. We are recommending that the Auditee reduce costs claimed by the amount of understated credits.

Medicare requires the Intermediary/Carrier to charge a private insurance provider for the medical information in a Medicare claim. The information may be provided internally to the Auditee's private lines of business or externally to another insurer including the State Medicaid program. As of June 1, 1986, carriers and intermediaries were required to reimburse Medicare for the medical information based on rates developed through a cost allocation.

The Medicare Agreement, Article XXIII, paragraph A, provides that;

"The Plan's complimentary insurance claims process may be integrated with its Medicare insurance claims process in accordance with Regulations and General Instructions. When the insurance processes are totally or partially integrated, all costs shall be charged to the appropriate line of business and indirect costs shall be prorated on appropriate allocation bases consistent with the Plan's established principles of allocating indirect costs as stipulated in Article XIII B."

Also, Section 1601(c) and 4601 (c) of the intermediary and carrier manual states:

"...Charges to the complimentary insurer are determined by cost allocation. As used in this section, the term allocation means to distribute all costs to Medicare and complimentary insurance in such proportion as to reflect the benefits received by each program. In selecting the appropriate method of allocation consider the benefits derived from each function. Where mutual benefits are derived full cost sharing is required..."

It further states:

"...When allocating costs to complimentary insurance,...observe the following principles:

- Charge all direct costs to the appropriate lines of business,
- Prorate indirect costs on an appropriate bases subject to audit...

A total of \$769,770 was cost questioned in the prior audit report covering fiscal years 1985 to 1988. Also, it was recommended that the Plan develop an approved allocation method for distributing complimentary claim costs between Medicare and the complimentary crossover claims.

We found that except for 1992, the complimentary credits for the fiscal years 1989 through 1993 were understated. The Auditee did not calculate rates for 1989 and 1990. Instead, the Auditee used rates that were established prior to June 1, 1986. In 1991, the Auditee agreed upon a rate calculation with HCFA. However, the rates used during fiscal year 1991 were not calculated in accordance with the approved plan. The Auditee made a mathematical error in the 1992 rate calculation resulting in an overstatement of credits. Rates used in fiscal year 1994 were calculated appropriately and properly applied.

The Auditee agreed to recalculate the rates for 1989 through 1993 in accordance with HCFA's approved plan, and determine the proper complimentary credit amounts. Our review showed that the recalculated rates resulted in the following adjustments.

<u>Year</u>	<u>Arkansas</u>		<u>Louisiana</u> <u>Part B</u>	<u>Cost</u> <u>Questioned</u>	<u>Total</u> <u>Overbudget</u>
	<u>Part A</u>	<u>Part B</u>			
1994	\$ 0	\$ 0	\$ 0	\$ 0	
1993	(2,749)	0	0	(2,749)	
1992	14,467	144,403	25,938		\$ 184,808
1991	(41,814)	(96,813)	(21,178)	(159,805)	
1990	(62,472)	(232,463)	(25,864)	(320,799)	
1989	(80,664)	(255,060)	(15,509)	(351,233)	
Total	<u>\$(173,232)</u>	<u>\$(439,933)</u>	<u>\$(36,613)</u>	<u>\$(834,586)</u>	<u>\$ 184,808*</u>

*Due to an error, the Auditee allocated Medicare excess credits in 1992. However, we did not recommend an adjustment because it would exceed the approved budget.

Recommendation

We recommend that the Auditee adjust the applicable fiscal year FACP's by a total of \$834,586. Also, HCFA should consider the \$184,808 in resolving fiscal year 1992 administrative costs.

Auditee Response

Auditee officials agree with the finding and recommendation. Also, they requested the excess crossover credits for fiscal year 1992 be applied to other recommended financial adjustments for the period. (See Auditee Response dated July 1, 1996)

EMPLOYEE HEALTH INSURANCE

The Auditee offered its employees several types of health insurance coverage. Most of the employees selected either Health Maintenance Organization (HMO) or the Major Medical and Preferred Provider Organization (PPO) group plan. Our analysis of the health insurance premium calculations, income, and expenses for each of these plans showed that Medicare was overcharged a total of \$186,021 during the audit period. Also, the Auditee had accumulated a \$4.5 million reserve balance on the HMO group plan that may have resulted in unreasonable charges to Medicare. Details of our findings are provided in paragraphs that follow.

HMO GROUP PLAN

The Auditee established an HMO health benefit group plan in December 1988, for both active and retired employees. This plan was funded through premiums paid fully by the employer. The HMO is a subsidiary of the firm and provides benefits to employees located in Arkansas. This plan is an experienced rated group. Therefore, the premiums are determined based on past claims history. Our analysis of the premium calculations showed the following:

Reserve Balance: At June 30, 1994, the Auditee had accumulated a \$4.5 million reserve balance in the HMO group plan. The following information was obtained from the Auditee's actuary pertaining to the HMO group plan:

<u>Plan Year</u>	<u>Adjusted Income</u>	<u>Claims</u>	<u>Reserve</u>
1989 (Start 3/1/89)	\$1,610,504	\$ 839,180	\$ 771,324
1990	2,258,172	1,656,627	601,545
1991	2,479,956	2,416,967	62,989
1992	3,006,005	2,413,503	592,502
1993	3,419,407	2,330,509	1,088,898
1994	3,618,832	2,214,273	<u>1,404,559</u>
Accumulative Reserve			<u>\$4,521,817</u>

Based on the claims expense for 1993 and 1994, it appears the reserve balance would be adequate to cover about two years of claims expenses. In our opinion, the reserve amount may be unreasonable. However, we believe HCFA should evaluate the reserve balance and determine if that amount is unreasonable.

Interest on Reserve Balance: The Auditee earned interest on the reserve balance in each year covered by the audit. However, the Auditee's rate calculation as shown on the Renewal Rating Worksheet, did not indicate that the interest income was considered in establishing the premiums. Also, we determined that Medicare did not receive a credit for its share of the interest income.

Title 48 CFR Part 9904.416-50(a)(1)(i) provides that;

“(i) The premium cost applicable to a given policy term shall be assigned pro rata among the cost accounting periods covered by the policy term...A refund, dividend or additional assessment shall become an adjustment to the pro rata premium costs of the earliest cost accounting period in which the refund or dividend is actually or constructively received or in which the additional assessment is payable.”

In addition, Part 31.201-5 provides that;

“...the applicable portion of any income,...relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction...”

Based on these requirements, we concluded Medicare should receive a credit adjustment.

We calculated the interest income on the average reserve balance and determined Medicare's share. The Auditee's experienced Return on Investment rate was used to calculate the interest income and the corporate salary dollar ratio was (excluding Louisiana employees) used to allocate the income. The results are as follows:

<u>Fiscal Year</u>	<u>Average Reserve Balance</u>	<u>Interest Income</u>	<u>Arkansas</u>		<u>Louisiana</u>	<u>Medicare Share of Interest Income</u>
			<u>Part A</u>	<u>Part B</u>	<u>Part B</u>	
1994	\$ 351,381	\$ 26,846	\$ 7,102	\$ 15,388	\$ 10,276	\$ 32,766
1993	937,436	73,214	4,642	9,201	5,416	19,259
1992	1,099,553	76,969	4,501	8,597	5,097	18,195
1991	1,214,279	70,792	2,810	8,746	6,188	17,744
1990	1,830,299	81,082	4,778	10,439	6,986	22,203
1989	2,904,738	135,942	2,193	4,381	1,632	8,206
			<u>\$ 26,026</u>	<u>\$ 56,752</u>	<u>\$35,595</u>	<u>\$118,373</u>

The interest income applicable to Medicare is cost questioned.

PPO GROUP INSURANCE

During the period covered by audit, the Auditee offered its employees a PPO group health plan that provided hospital, surgical, medical, dental, and extended benefits. The funding agreement between the certified group and the carrier (Arkansas Blue Cross and Blue Shield) was that the group would pay cost of claims, estimated incurred claims, administrative expenses, and large claims and organ transplant pool expenses. This plan also included a maximum liability amount to limit the amount owed by the group at settlement. Final settlement was 270 days after the end of the policy year. Premiums on this plan were paid fully by the employer.

Our review of the premium calculation showed that a risk factor was included in the premium rates. The intent of this risk factor was to establish a reserve balance for all cost plus groups and to cover possible non-payment of claims by the client. We believe the risk factor is unallowable because the client is the Auditee. Also, the risk factor is a contingency cost as defined in FAR 48CFR Part 31.205-7, which states;

“(a) Contingency,...means a possible future event or condition arising from presently known or unknown causes, the outcome which is indeterminable at the present time.

(b) Costs for contingencies are generally unallowable...”

Accordingly, we contend the risk factor is unallowable and should not have been allocated to Medicare.

We requested that the firm calculate the amount of risk costs charged to Medicare. The risk factors applied during the audit period were:

<u>Fiscal Year</u>	
1989-1991	1.1%
1992-1994	1.6%

The firm provided a calculation of risk costs allocated to Medicare for fiscal years 1989-1993 using actual paid claims at annual settlement. The firm had not issued the 1994 settlement documents. Therefore, we calculated the risk amount based on recorded paid claims as shown in the Renewal Rate Data Sheets. Medicare was allocated the following amounts:

<u>Fiscal Year</u>	<u>Arkansas</u>		<u>Louisiana</u>	<u>Total</u>
	<u>Part A</u>	<u>Part B</u>	<u>Part B</u>	<u>Unallowable Amount</u>
1994	\$ 2,164	\$ 4,689	\$ 6,264	\$ 13,117
1993	3,152	6,248	8,029	17,429
1992	2,414	4,611	6,002	13,027
1991	1,086	3,381	4,004	8,471
1990	1,768	3,862	4,346	9,976
1989	<u>1,224</u>	<u>2,515</u>	<u>1,889</u>	<u>5,628</u>
	<u>\$11,808</u>	<u>\$25,306</u>	<u>\$30,534</u>	<u>\$67,648</u>

The unallowable amount is cost questioned.

Recommendation:

We recommend that:

1. The Auditee adjust applicable FACP's by a total of \$186,021 as follows:

<u>Questioned Items</u>	<u>1994</u>	<u>1993</u>	<u>1992</u>	<u>1991</u>	<u>1990</u>	<u>1989</u>	<u>Total</u>
Contingency Cost	\$13,117	\$17,429	\$13,027	\$ 8,471	\$ 9,976	\$ 5,628	\$ 67,648
Interest Income	<u>32,766</u>	<u>19,259</u>	<u>18,195</u>	<u>17,744</u>	<u>22,203</u>	<u>8,206</u>	<u>118,373</u>
Total Questioned	<u>\$45,883</u>	<u>\$36,688</u>	<u>\$31,222</u>	<u>\$26,215</u>	<u>\$32,179</u>	<u>\$13,834</u>	<u>\$186,021</u>

Distribution of the questioned costs to each Medicare Part is provided in the finding.

2. HCFA determine if the HMO reserve balance is reasonable. Also, HCFA should pursue recovery of Medicare's share of any amounts determined to be excessive.

Auditee Response

Auditee officials agree with our finding on Interest Income but not with our calculation of the recommended questioned cost. They assert that in addition to claims expense the administrative expenses should be deducted from the reserve balance. By deducting the administrative expenses the adjusted interest income questioned is \$118,373.

These officials agree with our finding on Contingency Cost. They recalculated the questioned contingency amount using the 1994 final settlement documentation. The adjusted contingency cost questioned is \$67,648. No comments were provided on the accumulated reserve balance and our recommendation for HCFA. (See Auditee Response dated July 1, 1996)

Auditor Comment

Additional documentation was provided to support that administrative expenses were not included in the claims expenses we used to calculate interest income. We agree that administrative expenses should be included in the calculation. Therefore we revised the finding and recommendation to reflect this adjustment. The revised questioned interest income is \$118,373.

Regarding the Contingency Costs, we agree with the Auditee adjustments to the 1994 amounts. As stated in the finding the 1994 settlement document had not been issued and we used estimates for that period. The revised questioned contingency cost is \$67,648.

EXECUTIVE COMPENSATION COSTS

Medicare was charged \$228,396 in unreasonable amounts for executive compensation increases during the four fiscal periods 1991 through 1994. The Auditee's executives, in positions of Vice President or higher, received compensation increases which significantly exceeded increases received by executives in similar positions as reported by the Bureau of Labor Statistics. Section 31.201-2(a) of FAR states that one of the factors to be considered in determining whether a cost is allowable, is whether the cost is reasonable.

Regarding reasonableness, Section 31.205-6(b) of FAR states;

"Based on an initial review of the facts, contracting officers or their representatives may challenge the reasonableness of any individual element or the sum of the individual elements of compensation paid or accrued to particular employees or classes of employees. In such cases, there is no presumption of reasonableness and, upon challenge, the contractor must demonstrate the reasonableness of the compensation item in question."

To assess the reasonableness of the executive compensation increases, we compared total compensation paid to the Auditee's top executives to their base year compensation adjusted forward using the Bureau of Labor Statistics' ECI for wages and salaries for executive, administrative, and managerial occupations. The compensation amounts we used included the executive annual salary, bonus incentives, and other benefits paid by the employer. Benefits included 401K, life and health insurance, auto allowances, spouse travel, etc.

In our opinion, the ECI provides a valid measure of reasonableness because it discloses the average percentage of annual increases received by executives in similar management positions. The base year period we used was the later of fiscal year 1990 or the year an employee started in a position. Comparisons were exclusive of promotions. We did not attempt to determine the reasonableness of the base year compensation.

We found that the executive compensation allocated to Medicare cost centers during 1991 through 1994 included compensation increases that clearly exceeded the ECI. The executive compensation increased an average of approximately 34 percent from 1990 through 1994, as compared to the ECI increase of 14 percent for the same period. Consequently, the Auditee allocated \$228,396, of unreasonable salary increases to Medicare during fiscal years 1991 through 1994. This amount was allocated as follows:

<u>Fiscal Year</u>	<u>Arkansas</u>		<u>Louisiana</u>	<u>Total</u>
	<u>Part A</u>	<u>Part B</u>	<u>Part B</u>	
1991	\$ 2,014	\$ 5,176	\$ 4,090	\$ 11,280
1992	10,431	19,247	14,321	43,999
1993	8,360	30,776	26,523	65,659
1994	<u>16,456</u>	<u>47,302</u>	<u>43,700</u>	<u>107,458</u>
Total	<u>\$ 37,261</u>	<u>\$102,501</u>	<u>\$ 88,634</u>	<u>\$228,396</u>

The Auditee eliminated overhead salaries and benefits in several cost centers allocated to Medicare to meet budget limitations in fiscal years 1993 and 1994. Our calculation of salary increases for fiscal years 1993 and 1994 has been adjusted to compensate for amounts eliminated.

We cost question the total of \$228,396 as unreasonable compensation increases charged to Medicare.

Recommendation:

We recommend that the Auditee:

1. Adjust the applicable FACP's by a total of \$228,396.
2. Establish reasonable ceilings on the top executive's compensation increases allocated to Medicare.

Auditee Response

Auditee officials do not agree with our finding or recommendation. They are concerned that the Auditor's comparisons were exclusive of promotions. Therefore the Auditors would not consider the individual effects of promotion and merit increases.

Strong disagreement was expressed concerning the comparison of positions in the health insurance industry with all other industrial companies. They indicated that the competitiveness in the health insurance industry has greatly accelerated within the last few years. Consequently they contend it is misleading to compare health industry positions to any and all executives, administratives and managerial positions, generically, regardless of size, complexity, or the industry.

According to the Auditee, salary levels were recommended by the Hay Management Company based on job requirements related specifically to the banking and finance industry. Information from sources such as the Hay Management Company and Hewett Associates indicates that health insurance industry increases were greater than those reflected in the ECI. Increases in the health insurance industry were nearer 20 percent compared to the ECI's 14 percent.

Auditee officials did not believe that a one time incentive or bonus payment should be included in calculating accumulative increases. Also, they were uncertain whether the Auditor had considered all the executive salary amounts that were excluded from FACP's in FY 1993 and FY 1994. These exclusions were made to avoid exceeding budget. (See Auditee Response dated June 14, 1996)

Auditor Comment

Our comparisons are exclusive of any obvious promotions. For example, an Executive VP was promoted to the CEO position in 1992. We computed the VP's 1992 increase by comparing the VP's 1992 compensation to the VP's 1991 compensation. The compensation increase for promotion to CEO was not computed until the second year in that position. Generally the information provided by the Auditee did not show a breakdown of the compensation increase by factors such as promotion and merit increase.

Regarding the comparison of executive positions in the health insurance industry to positions in all type industries, we reorganize this may not be entirely reasonable or accurate. However, the Auditee's compensation increases during the period of our coverage was 34 percent compared to the Hay Management's cited 20 percent for the same period. In our opinion, this variance shows that the Auditee's increases were significantly above the health industry average.

In our computations we excluded the retiring CEO's retirement bonus because it is a non recurring type compensation and not included in the ECI. One-time incentive or bonus payments for non retiring executives were considered recurring compensation and according to the Bureau of Labor Statistics a part of the ECI.

The Auditee had eliminated certain overhead cost center amounts from the FACP to avoid exceeding the approved budget. We considered these eliminations in our allocations of the ECI variances.

We still believe our finding and recommendations are valid.

PERSONAL USE OF CORPORATE AUTO

During fiscal year 1989 through 1991, the Auditee allocated \$134,428 of unallowable auto expenses to Medicare. The unallowable expenses represented the cost of employees' personal use of company-owned vehicles. These costs are questioned.

FAR Section 31.205.6(m)(2) provides;

“...That portion of the costs of company furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable regardless of whether the cost is reported as taxable income to the employees...”

Our review showed that the Auditee's system did identify employees with assigned company-owned vehicles and the mileage related to personal usage. Costs associated with the personal usage was reported on the employees IRS W-2 forms. However, during fiscal year 1989 through 1991, the Auditee did not credit Medicare for its share of these costs. A similar finding was reported in the prior audit report for fiscal years 1985 through 1988. As a result of that audit, the Auditee started crediting Medicare in fiscal year 1992.

The Auditee had identified the following amounts of auto expenses related to employee's personal usage:

FY	<u>Fiscal Year</u>	Corporate <u>Total</u>	Medicare <u>Share</u>	<u>Arkansas</u>		<u>Louisiana</u>
				<u>Part A</u>	<u>Part B</u>	<u>Part B</u>
1991		\$171,499	\$ 54,096	\$12,440	\$16,087	\$25,569
1990		133,749	40,959	10,324	12,748	17,887
1989		<u>131,799</u>	<u>39,373</u>	<u>9,732</u>	<u>15,052</u>	<u>14,589</u>
Total Questioned Cost		<u>\$437,047</u>	<u>\$134,428</u>	<u>\$32,496</u>	<u>\$43,887</u>	<u>\$58,045</u>

Recommendation:

We recommend the Auditee adjust the applicable FACP's by the a total of \$134,428.

Auditee Response

Auditee officials agree with the finding and recommendation. (See Auditee Response dated June 14, 1996)

MISCELLANEOUS UNALLOWABLE COSTS

The Auditee charged Medicare a total of \$58,762 for miscellaneous type unallowable expenses. Most of these expenses were minor in amount. However, the Auditee had been previously informed of these types of unallowable expenses by HCFA or in a prior audit report. Accordingly, the unallowable expense should have been eliminated from allocations to Medicare.

BANK ACCOUNT SERVICE FEES

The Auditee claimed a total of \$27,469 in bank account fees during fiscal year 1990 and 1991. We do not consider these fees to be an ordinary and necessary cost for Medicare contract performance. Accordingly, we are recommending the Auditee reimburse Medicare.

The Auditee received reimbursement from Medicare through letter-of-credit funding. During the period of audit, the Auditee had used a "checks paid or zero balance" method of funding its accounts payable. Under this method, funds were drawn from the Medicare letter-of-credit and deposited in the general operating account. On a daily basis, funds were drawn from the general operating account to cover only the amount required for that day. The Auditee invested the funds remaining in the general operating account and earned interest. Bank service fees were paid and then allocated to all lines of business including Medicare through Account 6475 Bank Account Maintenance Fees.

In late 1991, the Auditee determined that the appropriate allocation base for bank service fees was against investment earnings. Subsequently, all bank service fees were allocated to the investment line of business. We found that the Auditee did not adjust Medicare for bank service fees claimed in fiscal years 1990 and 1991.

In summary, Medicare was overcharged the following:

Fiscal Year	<u>Arkansas</u>		<u>Louisiana</u>	<u>Total</u>
	<u>Part A</u>	<u>Part B</u>	<u>Part B</u>	
1990	\$ 1,637	\$ 3,589	\$ 5,745	\$ 10,971
1991	<u>2,990</u>	<u>5,352</u>	<u>8,156</u>	<u>16,498</u>
	<u>\$ 4,627</u>	<u>\$ 8,941</u>	<u>\$13,901</u>	<u>\$27,469</u>

Recommendation

We recommend that the Auditee adjust applicable FACP's by a total amount of \$27,469.

Auditee Response

Auditee officials agree with the finding and recommendation. (See Auditee Response dated June 14, 1996)

ANNUAL REPORTS

The cost related to issuing an annual report was questioned in a prior audit report that covered fiscal years 1985 through 1988. This cost was determined to be unallowable because the report was a marketing effort rather than a simple reporting mechanism. The Auditee agreed with the finding and made appropriate adjustments to the FACP's.

FAR Title 48 CFR 31.205-1(f)(5) provides that the following public relations and advertising costs are unallowable;

"Cost of promotional material, motion pictures...and other media that are designed to call favorable attention to the contractor and its activities."

We found that the Auditee continued to allocate annual report costs to Medicare during the period of this audit. Except for fiscal year 1993, the Auditee charged Medicare for the annual report. A total of \$23,885 was allocated to Medicare through Natural Account 6926 Annual Report.

The following amounts were charged to Medicare:

Fiscal Year	Arkansas		Louisiana	Total Cost Questioned
	Part A	Part B	Part B	
1989	\$ 1,242	\$ 2,662	\$ 1,963	\$ 5,867
1990	2,215	4,955	7,075	14,245
1991	223	373	589	1,185
1992	406	806	1,169	2,381
1994	35	73	99	207
Total	<u>\$ 4,121</u>	<u>\$ 8,869</u>	<u>\$10,895</u>	<u>\$ 23,885</u>

Recommendation:

We recommend the Auditee adjust the applicable FACP's by a total of \$23,885.

Auditee Response

Auditee officials agree with the finding and recommendation. (See Auditee Response dated June 14, 1996)

LEGAL FEES

The Auditee charged \$3,690 for legal fees to Louisiana Part B. These fees paid for an investigation involving asbestos contained in office space being leased from Louisiana Blue Cross/Blue Shield (LA- BC/BS). Based on our review of information relating to that investigation, we concluded the lessor, LA-BC/BS, should be responsible for the legal fees; not Medicare. Accordingly, we cost questioned the \$3,690 as unallowable.

During 1990, the Auditee learned that the office space housing its Louisiana Part B operations contained asbestos. This office space was leased from the LA BC/BS. After occupying the building, the Auditee's staff discovered that the LA BC/BS had previously conducted a test for asbestos in the building. However, the Auditee was not informed prior to leasing the facility that it contained asbestos. As soon as Auditee officials were aware of the asbestos problem, LA BC/BS was notified that they would be responsible for any cost or damages incurred because of their failure to provide the information.

In our opinion, the Auditee took the appropriate actions related to the asbestos problem. However, we contend the legal fees relating to the asbestos investigation should be LA BC/BS's responsibility; not Medicare.

Recommendation

We recommend that the Auditee adjust the FACP by \$3,690.

Auditee Response

Auditee officials agree with the finding and recommendation. (See Auditee Response dated June 14, 1996)

STATE LICENSE REQUIREMENT

The Auditee established Natural Account 6620-State License Requirements to allocate costs associated with agent exams, licenses, and filing fees. An analysis of the account indicated that most of the agents were sales personnel. Medicare is a government program, no agents are needed to sell policies. Consequently, this cost would not benefit Medicare and is unallowable. During the period of audit, a total of \$1,844 was allocated to Medicare.

FAR Title 48 CFR 31.201-4 states;

“...a cost is allocable to a Government contract if it (a) is incurred specifically for the contract; (b) benefits both the contract and other work...”

State License fees were questioned in the prior audit report covering fiscal years 1985 through 1988. We determined that Medicare was overcharged \$1,844 during fiscal years 1989 through 1994 as follows:

Fiscal Year	<u>Arkansas</u>		<u>Louisiana</u>	<u>Total</u>
	<u>Part A</u>	<u>Part B</u>	<u>Part B</u>	
1989	\$ 195	\$ 392	\$ 233	\$ 820
1990	141	340	476	957
1991	-	-	-	-
1992	-	3	2	5
1993	-	-	-	-
1994	<u>22</u>	<u>7</u>	<u>33</u>	<u>62</u>
Total	<u>\$358</u>	<u>\$742</u>	<u>\$744</u>	<u>\$1,844</u>

Recommendation:

We recommend the Auditee adjust the applicable FACP's by a total of \$1,844.

Auditee Response

Auditee officials agree with the finding and recommendation. (See Auditee Response dated June 14, 1996)

SOCIAL ACTIVITY

The Auditee charged Medicare for social activities relating to client entertainment in the amount of \$530. Account Number 6930-Adv. Social Activity was set up to accumulate costs for client promotional events.

FAR Title 48 CFR 31.205-14 states;

“Costs of amusement, diversion, social activities such as tickets to shows, meals...are unallowable.”

The following costs were allocated to Medicare from that account:

1994	<u>Arkansas</u>		<u>Louisiana</u>	<u>Total</u>
	<u>Part A</u>	<u>Part B</u>	<u>Part B</u>	
	<u>\$106</u>	<u>\$210</u>	<u>\$214</u>	<u>\$530</u>

Recommendation:

We recommend that the Auditee adjust the applicable FACP's by a total of \$530.

Auditee Response:

Auditee officials agree with the finding and recommendation. (See Auditee Response dated June 14, 1996)

POLLOR LINE CHARGES

One of the telephone services that the Auditee used was referred to as the 682 Pollor line. Charges for that service were allocated to Medicare through Natural Account 6178. In 1989, the Auditee discontinued using the pollor line. A journal entry was prepared in September 1989, to reallocate Medicare's share of pollor line costs from October 1988 through August 1989, to a non-Medicare line of business. However, Medicare was not eliminated from the allocation tables until sometime in FY90. As a result, Medicare was overcharged \$1,344.

Medicare was overcharged \$1,344 as follows:

<u>Fiscal Year</u>	<u>Arkansas</u>		<u>Louisiana</u>	<u>Total</u>
	<u>Part A</u>	<u>Part B</u>	<u>Part B</u>	
1989	\$ 82	\$ 112	\$ 56	\$ 250
1990	<u>237</u>	<u>600</u>	<u>257</u>	<u>1,094</u>
Total	<u>\$319</u>	<u>\$712</u>	<u>\$313</u>	<u>\$1,344</u>

Recommendation:

We recommend the Auditee adjust the applicable FACP's by a total of \$1,344.

Auditee Response:

Auditee officials agree with the finding and recommendation. (See Auditee Response dated June 14, 1996)

SUMMARY OF MISCELLANEOUS UNALLOWABLE COSTS

The miscellaneous unallowable expenses charged to Medicare by fiscal year are:

	<u>Arkansas</u>		<u>Louisiana</u>	<u>Total</u>
	<u>Part A</u>	<u>Part B</u>	<u>Part B</u>	
1989	\$ 1,519	\$ 3,166	\$ 2,252	\$ 6,937
1990	4,230	9,484	17,243	30,957
1991	3,213	5,725	8,745	17,683
1992	406	809	1,171	2,386
1994	<u>163</u>	<u>290</u>	<u>346</u>	<u>799</u>
	<u>\$ 9,531</u>	<u>\$19,474</u>	<u>\$29,757</u>	<u>\$58,762</u>

Recommendations related to these amounts are presented with each of the above findings.

RETENTION OF SUPPORTING DOCUMENTATION

We found that the Auditee had not retained all documentation to support certain items of costs claimed. Article XX of the Medicare Part B contract required the contractor to retain all records until expiration of 3 years after final payment for the term of the contract. A similar finding was disclosed in HCFA's risk assessment review.

Some examples of documentation that could not be located and of incomplete documentation follows:

Return on Investment (ROI) - The Auditee was unable to locate the detail records used in calculating the 1989 ROI rates and six months of the 1994 rates. Further, the Auditees had not entered this information in the computer system to provide the necessary backup. Generally, the information supporting the calculation of ROI rates was attached to the journal entry documents.

To support the 1989 and 1994 rate information, it was necessary for the Auditee to expend considerable time in manually reconstructing the calculation.

Square Footage Usage - During the period covered by audit, the Auditee moved claims processing and administrative functions several times. Also, building engineering officials indicated that square footage was revised numerous times. However, the Auditee did not retain all the specific information on what space was revised and if the space was vacant for any length of time. Further, the Auditee could not identify the various cost centers that were effected by square footage revisions. Without that information, it was difficult to substantiate any allocation tables based on square footage.

RETENTION OF SUPPORTING DOCUMENTATION (Cont'd)

The auditee does maintain adequate records on current space usage. To substantiate any changes in square footage allocation tables, the Auditee should maintain a complete file on all prior space usage and any revisions. This would include identifying all cost centers effected by moves or space revisions.

Medicare Crosswalk - A single file was not maintained to support all adjustments to the FACP. Support for adjustment was maintained in the IER files. Further, adjustments were not entered into the automated system to record the accumulated changes. Therefore, the FACP file reflected only the latest IER adjustment to the final FACP. HCFA had disclosed this situation in its risk assessment review.

We also noted that the FACP file is currently being updated monthly with all adjustments. However, the adjustment document is generally hand-written with no documented support such as, time sheets, invoices, or accumulative time records for special projects. The Auditee should maintain one file that contains all the supporting documentation for any adjustments to the FACP.

Recommendation:

We recommend the Auditee perform a review of its system to determine that all documentation is retained to support costs claimed on Medicare. In those instances where deficiencies are noted, an adequate system should be established to ensure the supporting documentation is retained.

Auditee Response:

Auditee officials indicated that the Government Programs Accounting Division has recently staffed a section that will monitor the entire documentation procedures relating to contracts. (See Auditee Response dated June 14, 1996)

OTHER MATTERS

Significant EDP Expenditures

The firm's three significant EDP expenditures during the audit period were as follows:

On October 26, 1990, the Auditee requested approval from HCFA to purchase software for the Part A Central Maintenance Users to facilitate the transmission of files. This request for \$150,000 included amounts for annual maintenance to keep users compatible with the system. HCFA approved the request in the NOBA.

On October 29, 1991, the Auditee requested approval from HCFA to lease an IBM 3090-400E central processing unit for \$35,071 per month. HCFA sent an approval letter on December 20, 1991, with the condition that the excess capacity not be charged to Medicare. The HHS-OIG reviewed the system in June 1992, and recommended that the maximum capacity be set at 94 percent instead of 80 percent. The Auditee adjusted the costs allocated to reflect the 94 percent. We reviewed the calculation and verified amounts to the general ledger.

On April 13, 1992, the Auditee requested approval from HCFA to purchase an eighteen tract magnetic tape media. This item was purchased in August 1992 for \$1,152,996. HCFA was not required to approve the purchase because it was an acquisition of equipment.

Interim Expenditure Reports

We verified actual costs as reported on the Arkansas Blue Cross and Blue Shield, interim expenditure reports (IER's). Our tests were performed to determine clerical accuracy, reliability of allocation methods, and adequacy of supporting cost reports. Based on the results of the work performed, we concluded that the IER's are materially accurate.

Pension Plan Audit

During 1993, the Department of Health and Human Services, Office of Inspector General (OIG), issued two audit reports concerning the Auditee's pension plan activities for the period January 1, 1986, through December 31, 1991. Our follow-up on these two audits showed the following:

Audit of Unfunded Pension Costs

OIG found that the Auditee had funded its pension plan in accordance with ERISA requirements. However, the pension plan was underfunded by \$955,454 in accordance with Cost Accounting Standards requirements. Accordingly, OIG recommended that the Auditee separately identify and eliminate this amount from amortization components of future pension costs. The Auditee generally agreed with OIG's recommendations. Our review showed that the Auditee had complied with OIG's recommendations.

Audit of Medicare Contractor's Pension Segmentation

OIG found that the Auditee had overstated the Medicare segment assets by a net amount of \$37,384 during the period of audit. Accordingly, OIG recommended that the asset segment be adjusted by that amount. The Auditee agreed with the recommendation. We found that the Auditee made the adjustment in the next actuarial report.

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COMMENTS ON EVALUATION OF INTERNAL CONTROL STRUCTURE

We have audited the Medicare Part A and B Statement of Administrative Costs of Arkansas Blue Cross and Blue Shield, for the fiscal years ended September 30, 1994, 1993, 1992, 1991, 1990 and 1989, and have issued our report thereon dated February 8, 1995.

We conducted our audit in accordance with generally accepted governmental auditing standards. In planning and performing our audit of Arkansas Blue Cross Blue Shield, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

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

- Property and Equipment
- Cash Receipts
- Cash Disbursements
- Purchasing and Receiving
- Accounts Payable and Accrued Expenses
- Payroll

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

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of a specific internal control structure element does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the internal control structure and its operations that we consider to be material weaknesses as defined above.

The management of Arkansas Blue Cross and Blue Shield, is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system 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 system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

This report is intended solely for the use of the management of Arkansas Blue Cross and Blue Shield, and the Department of Health and Human Services in regard to their agreement to administer the Medicare program and should not be used for any other purpose.

Kansas City, Missouri
February 8, 1995

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COMMENTS ON COMPLIANCE WITH PERTINENT REGULATORY REQUIREMENTS

We have audited the "Final Administrative Cost Proposals" (FACP's), of Arkansas Blue Cross and Blue Shield, for the fiscal years ended September 30, 1994, 1993, 1992, 1991, 1990 and 1989, and have issued our report thereon dated February 8, 1995.

We conducted our audit in accordance with generally accepted governmental auditing standards (Government Auditing Standards) and the "Audit Guide for the Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers under Title XVIII of the Social Security Act" (Audit Instruction E-1), dated February 25, 1991. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, grants, and binding policies and procedures applicable to Arkansas Blue Cross and Blue Shield, is the responsibility of Arkansas Blue Cross Blue Shield's management. As part of our audit, we performed tests of Arkansas Blue Cross Blue Shield's compliance with certain provisions of laws, regulations, contracts, grants, and binding policies and procedures. However, it should be noted that we performed those tests of compliance as part of obtaining reasonable assurance about whether the financial statements are free of material misstatement; our objective was not to provide an opinion on compliance with such provisions.

Our testing of transactions and records selected from Federal programs disclosed instances of noncompliance with those laws and regulations. All instances of noncompliance that we found and the programs to which they relate are identified in the Findings and Recommendations Section of this report.

Except as described above, the results of our tests indicate that with respect to items tested, Arkansas Blue Cross and Blue Shield, 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 Arkansas Blue Cross and Blue Shield, had not complied, in all material respects, with those provisions.

Members

American Institute of Certified Public Accountants

Missouri Society of Certified Public Accountants

This report is intended solely for the use of management of Arkansas Blue Cross and Blue Shield, and the Department of Health and Human Services in regard to their agreement to administer the Medicare program and should not be used for any other purpose.

Kansas City, Missouri
February 8, 1995

Doshi & Associates P.C.
Doshi & Associates, P.C.

USABLE CORPORATION AND SUBSIDIARIES
(A Wholly-Owned Subsidiary of Arkansas Blue Cross
and Blue Shield, A Mutual Insurance Company)

Consolidating Statement of Earnings (Loss)
and Retained Earnings (Deficit)

For the Year Ended December 31, 1993

Schedule 2

		<u>HMO</u> <u>Arkansas</u>
Revenues:		
Premiums, net of reinsurance	\$	27,134,585
Software installation and consulting		-
Administrative services		-
Investment income		131,714
Gain on sale of subsidiary		-
Other		<u>(1,622,864)</u>
Total revenues		<u>25,643,435</u>
Operating costs:		
Death, accident and health benefits		20,124,308
Operating expenses		<u>1,998,695</u>
Total operating costs		<u>22,123,003</u>
Earnings (loss) before provision for income tax and equity in earnings of subsidiaries		3,520,432
Provision (credit) for income taxes		<u>1,205,970</u>
Earnings (loss) before equity in earnings of subsidiaries		2,314,462
Equity in earnings of subsidiaries		<u>-</u>
Net earnings (loss)		2,314,462
Retained earnings (deficit), beginning of year		(1,867,361)
Dividends paid		<u>-</u>
Retained earnings (deficit), end of year	\$	<u>447,101</u>

HMO PARTNERS, INC.
STATEMENT OF INCOME
YEAR ENDED DECEMBER 31, 1994

PREMIUM REVENUES	\$ <u>52,852,322</u>
OPERATING EXPENSES	
Medical expenses	
Medical services	41,488,255
Capitation fees	4,871,943
Excess medical expenses (Note 2)	<u>(918,237)</u>
	<u>45,441,961</u>
General and administrative expenses	
Employee salaries and benefits	3,295,541
Advertising and printing	757,890
Rent	201,361
Other	<u>2,194,759</u>
	<u>6,449,551</u>
INCOME FROM OPERATIONS	<u>960,810</u>
OTHER INCOME (EXPENSE)	
Interest income	399,755
Interest expense	(156,166)
Other income	<u>142,583</u>
	<u>386,172</u>
INCOME BEFORE TAXES	1,346,982
PROVISION FOR INCOME TAXES (Note 8)	<u>550,000</u>
NET INCOME	<u><u>\$ 796,982</u></u>

See Notes to Financial Statements

**ARKANSAS BLUE CROSS BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART A
FOR THE PERIOD OCTOBER 1, 1988 THROUGH SEPTEMBER 30, 1989**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$3,683,998</u>	
FACP Costs Claimed		
Bills Payment	\$1,074,054	
Recons and Hearings	27,249	
Medicare Secondary Payer	345,283	
Medical Review & Utilization Review	211,902	
Provider Desk Reviews	407,405	
Provider Field Audits	905,763	
Provider Settlements	234,014	
Provider Reimbursement	272,657	
Productivity Investments	205,671	
Other	-	
Total	<u>\$3,683,998</u>	
Less Recommended Adjustments:		
Complimentary Credit	80,664	1
Interest HMO	2,193	2
Contingency Reserve	1,224	3
Personal Use of Corporate Auto	9,732	4
Miscellaneous Unallowable Costs	<u>1,519</u>	5
Total Recommended Adjustments	<u>95,332</u>	
Total Costs Recommended for Acceptance	<u>\$3,588,666</u>	

Note:

- (1) Represents the firm's recalculation of the complimentary credit based on allocation methodology developed in 1991.
- (2) Represents the interest income earned on the health insurance reserve.
- (3) Represents the amount associated with the risk factor built in the cost plus formula.
- (4) Represents the overcharge for the personal usage of the corporate automobile.
- (5) Represents various expenses that are unallowable.

**ARKANSAS BLUE CROSS BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART A
FOR THE PERIOD OCTOBER 1, 1989 THROUGH SEPTEMBER 30, 1990**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$3,802,491</u>	
FACP Costs Claimed		
Bills Payment	\$1,029,531	
Recons and Hearings	34,834	
Medicare Secondary Payer	378,869	
Medical Review & Utilization Review	165,832	
Provider Desk Reviews	577,910	
Provider Field Audits	718,232	
Provider Settlements	229,405	
Provider Reimbursement	292,932	
Productivity Investments	366,085	
OIG/GAO Studies	<u>6,503</u>	
Total	<u>\$3,800,133</u>	
Less Recommended Adjustments:		
Complimentary Credit	62,472	1
Interest HMO	4,778	2
Contingency Reserve	1,768	3
Personal Use Corporate Auto	10,324	4
Miscellaneous Unallowable Costs	<u>4,230</u>	5
Total Recommended Adjustments	<u>83,572</u>	
Total Costs Recommended for Acceptance	<u>\$3,716,561</u>	

Note:

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- (4) Represents the overcharge for the personal usage of the corporate automobile.
- (5) Represents various expenses that are unallowable.

**ARKANSAS BLUE CROSS BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART A
FOR THE PERIOD OCTOBER 1, 1990 THROUGH SEPTEMBER 30, 1991**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$4,327,733</u>	
FACP Costs Claimed		
Bills Payment	\$1,158,328	
Recons and Hearings	43,050	
Medicare Secondary Payer	397,226	
Medical Review & Utilization Review	168,096	
Provider Desk Reviews	380,999	
Provider Field Audits	854,210	
Provider Settlements	232,819	
Provider Reimbursement	345,317	
Productivity Investments	707,713	
IBPR Project	<u>24,096</u>	
Total	<u>\$4,311,854</u>	
Less Recommended Adjustments:		
Complimentary Credit	41,814	1
Interest HMO	2,810	2
Contingency Reserve	1,086	3
Personal Use of Corporate Auto	12,440	4
Executive Compensation Costs	2,014	5
Miscellaneous Unallowable Costs	<u>3,213</u>	6
Total Recommended Adjustments	<u>63,377</u>	
Total Costs Recommended for Acceptance	<u>\$4,248,477</u>	

Note:

- (1) Represents the firm's recalculation of the complimentary credit based on allocation methodology developed in 1991.
- (2) Represents the interest income earned on the health insurance reserve.
- (3) Represents the amount associated with the risk factor built in the cost plus formula.
- (4) Represents the overcharge for the personal usage of the corporate automobile.
- (5) Represents unreasonable executive compensation increases.
- (6) Represents various expenses that are unallowable.

**ARKANSAS BLUE CROSS BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART A
FOR THE PERIOD OCTOBER 1, 1991 THROUGH SEPTEMBER 30, 1992**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$4,392,779</u>	
FACP Costs Claimed		
Bills Payment	\$1,167,095	
Recons and Hearings	86,533	
Medicare Secondary Payer	532,909	
Medical Review & Utilization Review	243,972	
Provider Desk Reviews	511,510	
Provider Field Audits	853,905	
Provider Settlements	197,787	
Provider Reimbursement	341,164	
Productivity Investments	457,904	
Other	-	
Total	<u>\$4,392,779</u>	
Less Recommended Adjustments:		
Interest HMO	4,501	1
Contingency Reserve	2,414	2
Executive Compensation Costs	10,431	3
Miscellaneous Unallowable Costs	<u>406</u>	4
Total	<u>17,752</u>	*
Total Costs Recommended for Acceptance	<u>\$4,375,027</u>	

Note:

- (1) Represents the interest income earned on the health insurance reserve.
- (2) Represents the amount associated with the risk factor built in the cost plus formula.
- (3) Represents unreasonable executive compensation increases.
- (4) Represents various expenses that are unallowable.

*We did not offset questioned costs by the \$14,467 complimentary credit overcharge.

**ARKANSAS BLUE CROSS BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART A
FOR THE PERIOD OCTOBER 1, 1992 THROUGH SEPTEMBER 30, 1993**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$5,545,453</u>	
FACP Costs Claimed		
Bills Payment	\$1,163,144	
Recons and Hearings	154,472	
Medicare Secondary Payer	429,490	
Medical Review & Utilization Review	261,861	
Provider Desk Reviews	534,581	
Provider Field Audits	813,321	
Provider Settlements	252,777	
Provider Reimbursement	334,068	
Productivity Investments	1,502,269	
Fraud & Abuse	41,170	
Special Projects/Improper Payment	<u>58,300</u>	
Total	<u>\$5,545,453</u>	
Less Recommended Adjustments:		
Complimentary Credit	2,749	1
Interest HMO	4,642	2
Contingency Reserve	3,152	3
Executive Compensation Costs	<u>8,360</u>	4
Total Recommended Adjustments	<u>18,903</u>	
Total Costs Recommended for Acceptance	<u>\$5,526,550</u>	

Note:

- (1) Represents the firm's recalculation of the complimentary credit based on allocation methodology developed in 1991.
- (2) Represents the interest income earned on the health insurance reserve.
- (3) Represents the amount associated with the risk factor built in the cost plus formula.
- (4) Represents unreasonable executive compensation increases.

**ARKANSAS BLUE CROSS BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART A
FOR THE PERIOD OCTOBER 1, 1993 THROUGH SEPTEMBER 30, 1994**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$4,867,499</u>	
FACP Costs Claimed		
Bills Payment	\$1,208,927	
Recons and Hearings	156,200	
Medicare Secondary Payer	441,621	
Medical Review & Utilization Review	278,437	
Provider Desk Reviews	523,897	
Provider Field Audits	677,676	
Provider Settlements	205,137	
Provider Reimbursement	358,477	
Productivity Investments	964,932	
Benefit Integrity	<u>52,195</u>	
Total	<u>\$4,867,499</u>	
Less Recommended Adjustments:		
Interest HMO	7,102	1
Contingency Reserve	2,164	2
Executive Compensation Costs	16,456	3
Miscellaneous Unallowable Costs	<u>163</u>	4
Total Recommended Adjustments	<u>25,885</u>	
Total Costs Recommended for Acceptance	<u>\$4,841,614</u>	

Note:

- (1) Represents the interest income earned on the health insurance reserve.
- (2) Represents the amount associated with the risk factor built in the cost plus formula.
- (3) Represents unreasonable executive compensation increases.
- (4) Represents various expenses that are unallowable.

**ARKANSAS BLUE CROSS BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART B
FOR THE PERIOD OCTOBER 1, 1988 THROUGH SEPTEMBER 30, 1989**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$8,316,377</u>	
FACP Costs Claimed		
Claims Payment	\$4,996,510	
Reviews and Hearings	408,212	
Beneficiary/Physician Inquiry	808,905	
Professional Relations	47,713	
Medical Review & Utilization Review	1,102,933	
Medicare Secondary Payer	424,815	
Participating Physician	217,524	
Productivity Investments	262,465	
Carrier Bonus	47,300	
Other	-	
Total FACP Costs Claimed	<u>\$8,316,377</u>	
Less Recommended Adjustments		
Complimentary Credit	255,060	1
Interest HMO	4,381	2
Contingency Reserve	2,515	3
Personal Use Corporate Auto	15,052	4
Miscellaneous Unallowable Costs	<u>3,166</u>	5
Total Recommended Adjustment	<u>280,174</u>	
Total Costs Recommended for Acceptance	<u>\$8,036,203</u>	

Note:

- (1) Represents the firm's recalculation of the complimentary credit based on allocation methodology developed in 1991.
- (2) Represents the interest income earned on the health insurance reserve.
- (3) Represents the amount associated with the risk factor built in the cost plus formula.
- (4) Represents the overcharge for the personal usage of the corporate automobile.
- (5) Represents various expenses that are unallowable.

ARKANSAS BLUE CROSS BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART B
FOR THE PERIOD OCTOBER 1, 1989 THROUGH SEPTEMBER 30, 1990

<u>Operation</u>	<u>Administrative</u> <u>Costs</u>	<u>Note</u>
Total Budget	<u>\$8,901,771</u>	
FACP Costs Claimed		
Claims Payment	\$5,393,723	
Reviews and Hearings	492,546	
Beneficiary/Physician Inquiry	819,722	
Professional Relations	53,010	
Medical Review & Utilization Review	1,286,239	
Medicare Secondary Payer	333,547	
Participating Physician	264,914	
Productivity Investments	208,070	
Carrier Bonus	50,000	
Other	-	
Total FACP Costs Claimed	<u>\$8,901,771</u>	
Less Recommended Adjustments:		
Complimentary Credit	232,463	1
Interest HMO	10,439	2
Contingency Reserve	3,862	3
Personal Use Corporate Auto	12,748	4
Miscellaneous Unallowable Costs	9,484	5
Total Recommended Adjustment	<u>268,996</u>	
Total Costs Recommended for Acceptance	<u>\$8,632,775</u>	

Note:

- (1) Represents the firm's recalculation of the complimentary credit based on allocation methodology developed in 1991.
- (2) Represents the interest income earned on the health insurance reserve.
- (3) Represents the amount associated with the risk factor built in the cost plus formula.
- (4) Represents the overcharge for the personal usage of the corporate automobile.
- (5) Represents various expenses that are unallowable.

**ARKANSAS BLUE CROSS BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART B
FOR THE PERIOD OCTOBER 1, 1990 THROUGH SEPTEMBER 30, 1991**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$11,555,368</u>	
FACP Costs Claimed		
Claims Payment	\$6,118,901	
Reviews and Hearings	678,744	
Beneficiary/Physician Inquiry	807,085	
Professional Relations	108,313	
Medical Review & Utilization Review	1,210,675	
Medicare Secondary Payer	337,348	
Participating Physician	317,239	
Productivity Investments	1,913,459	
Carrier Bonus	53,900	
Other	-	
Total FACP Costs Claimed	<u>\$11,545,664</u>	
Less Recommended Adjustments:		
Complimentary Credit	96,813	1
Interest HMO	8,746	2
Contingency Reserve	3,381	3
Personal Use Corporate Auto	16,087	4
Executive Compensation Costs	5,176	5
Miscellaneous Unallowable Costs	<u>5,725</u>	6
Total Recommended Adjustment	<u>135,928</u>	
Total Costs Recommended for Acceptance	<u>\$11,409,736</u>	

Note:

- (1) Represents the firm's recalculation of the complimentary credit based on allocation methodology developed in 1991.
- (2) Represents the interest income earned on the health insurance reserve.
- (3) Represents the amount associated with the risk factor built in the cost plus formula.
- (4) Represents the overcharge for the personal usage of the corporate automobile.
- (5) Represents unreasonable executive compensation increases.
- (6) Represents various expenses that are unallowable.

**ARKANSAS BLUE CROSS BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART B
FOR THE PERIOD OCTOBER 1, 1991 THROUGH SEPTEMBER 30, 1992**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$11,689,417</u>	
FACP Costs Claimed		
Claims Payment	\$ 6,032,916	
Reviews and Hearings	732,739	
Beneficiary/Physician Inquiry	981,195	
Professional Relations	132,734	
Medical Review & Utilization Review	1,039,076	
Medicare Secondary Payer	582,738	
Participating Physician	266,913	
Productivity Investments	1,835,617	
Carrier Bonus/OIG Studies	85,489	
Other	-	
Total FACP Costs Claimed	<u>\$11,689,417</u>	
Less Recommended Adjustments:		
Interest HMO	8,597	1
Contingency Reserve	4,611	2
Executive Compensation Costs	19,247	3
Miscellaneous Unallowable Costs	809	4
Total Recommended Adjustment	<u>33,264</u>	
Total Costs Recommended for Acceptance	<u>\$11,656,153</u>	

Note:

- (1) Represents the interest income earned on the health insurance reserve.
- (2) Represents the amount associated with the risk factor built in the cost plus formula.
- (3) Represents unreasonable executive compensation increases.
- (4) Represents various expenses that are unallowable.

* This does not take into consideration the \$144,403 complimentary credit overcharge.

**ARKANSAS BLUE CROSS BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART B
FOR THE PERIOD OCTOBER 1, 1992 THROUGH SEPTEMBER 30, 1993**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$10,584,127</u>	
FACP Costs Claimed		
Claims Payment	\$5,821,588	
Reviews and Hearings	631,674	
Beneficiary/Physician Inquiry	852,625	
Provider Education & Training	141,234	
Medical Review & Utilization Review	1,106,676	
Medicare Secondary Payer	470,048	
Participating Physician	251,611	
Productivity Investments	868,377	
Other	-	
Fraud and Abuse	240,068	
Other	<u>200,226</u>	
Total FACP Costs Claimed	<u>\$10,584,127</u>	
Less Recommended Adjustments:		
Interest HMO	9,201	1
Contingency Reserve	6,248	2
Executive Compensation Costs	<u>30,776</u>	3
Total Recommended Adjustment	<u>46,225</u>	
Total Costs Recommended for Acceptance	<u>\$10,537,902</u>	

Note:

- (1) Represents the interest income earned on the health insurance reserve.
- (2) Represents the amount associated with the risk factor built in the cost plus formula.
- (3) Represents unreasonable executive compensation increases.

ARKANSAS-LOUISIANA BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - PART B
FOR THE PERIOD OCTOBER 1, 1993 THROUGH SEPTEMBER 30, 1994

<u>Operation</u>	<u>Administrative</u> <u>Costs</u>	<u>Note</u>
Total Budget	<u>\$10,240,929</u>	
FACP Costs Claimed		
Claims Payment	\$ 5,270,295	
Reviews and Hearings	627,668	
Beneficiary/Physician Inquiry	825,894	
Provider Education & Training	367,588	
Medical Review & Utilization Review	1,091,696	
Medicare Secondary Payer	519,773	
Participating Physician	252,599	
Productivity Investments	801,802	
Other	-	
Benefit Integrity	268,790	
Other	<u>214,824</u>	
Total FACP Costs Claimed	<u>\$10,240,929</u>	
Less Recommended Adjustments:		
Interest HMO	15,388	1
Contingency Reserve	4,689	2
Executive Compensation Costs	47,302	3
Miscellaneous Unallowable Costs	<u>290</u>	4
Total Recommended Adjustment	<u>67,669</u>	
Total Costs Recommended for Acceptance	<u>\$10,173,260</u>	

Note:

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- (3) Represents unreasonable executive compensation increases.
- (4) Represents various expenses that are unallowable.

ARKANSAS-LOUISIANA BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - LA PART B
FOR THE PERIOD OCTOBER 1, 1988 THROUGH SEPTEMBER 30, 1989

<u>Operation</u>	<u>Administrative</u> <u>Costs</u>	<u>Note</u>
Total Budget	<u>\$12,295,946</u>	
FACP Costs Claimed		
Claims Payment	\$7,443,848	
Reviews and Hearings	789,624	
Beneficiary/Physician Inquiry	1,324,618	
Professional Relations	59,324	
Medical Review & Utilization Review	1,458,979	
Medicare Secondary Payer	777,600	
Participating Physician	286,838	
Productivity Investments	86,315	
Physician Incentive Bonus	68,800	
Other	-	
Total FACP Costs Claimed	<u>\$12,295,946</u>	
Less Recommended Adjustments:		
Complimentary Credit	15,509	1
Interest HMO	1,632	2
Contingency Reserve	1,889	3
Personal Use Corporate Auto	14,589	4
Miscellaneous Unallowable Costs	<u>2,252</u>	5
Total Recommended Adjustments	<u>35,871</u>	
Total Costs Recommended for Acceptance	<u>\$12,260,075</u>	

Note:

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- (4) Represents the overcharge for the personal usage of the corporate automobile.
- (5) Represents various expenses that are unallowable.

ARKANSAS-LOUISIANA BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - LA PART B
FOR THE PERIOD OCTOBER 1, 1989 THROUGH SEPTEMBER 30, 1990

<u>Operation</u>	<u>Administrative</u> <u>Costs</u>	<u>Note</u>
Total Budget	<u>\$13,599,700</u>	
FACP Costs Claimed		
Claims Payment	\$ 8,041,763	
Reviews and Hearings	934,928	
Beneficiary/Physician Inquiry	1,242,924	
Professional Relations	79,199	
Medical Review & Utilization Review	2,079,894	
Medicare Secondary Payer	553,486	
Participating Physician	323,914	
Productivity Investments	263,992	
Other	-	
Physician Incentive Bonus	79,600	
Other	-	
Total FACP Costs Claimed	<u>\$13,599,700</u>	
Less Recommended Adjustments:		
Complimentary Credit	25,864	1
Interest HMO	6,986	2
Contingency Reserve	4,346	3
Personal Use Corporate Auto	17,887	4
Miscellaneous Unallowable Costs	<u>17,243</u>	5
Total Recommended Adjustments	<u>72,326</u>	
Total Costs Recommended for Acceptance	<u>\$13,527,374</u>	

Note:

- (1) Represents the firm's recalculation of the complimentary credit based on allocation methodology developed in 1991.
- (2) Represents the interest income earned on the health insurance reserve.
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- (4) Represents the overcharge for the personal usage of the corporate automobile.
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**ARKANSAS-LOUISIANA BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - LA PART B
FOR THE PERIOD OCTOBER 1, 1990 THROUGH SEPTEMBER 30, 1991**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$14,745,452</u>	
FACP Costs Claimed		
Claims Payment	\$ 9,288,704	
Reviews and Hearings	1,138,163	
Beneficiary/Physician Inquiry	1,268,927	
Professional Relations	139,290	
Medical Review & Utilization Review	1,671,154	
Medicare Secondary Payer	744,421	
Participating Physician	302,382	
Productivity Investments	51,271	
Other	-	
Physician Incentive Bonus	85,600	
Other	-	
Total FACP Costs Claimed	<u>\$14,689,912</u>	
Less Recommended Adjustments:		
Complimentary Credit	21,178	1
Interest HMO	6,188	2
Contingency Reserve	4,004	3
Personal Use Corporate Auto	25,569	4
Executive Compensation Costs	4,090	5
Miscellaneous Unallowable Costs	8,745	6
Total Recommended Adjustments	<u>69,774</u>	
Total Costs Recommended for Acceptance	<u>\$14,620,138</u>	

Note:

- (1) Represents the firm's recalculation of the complimentary credit based on allocation methodology developed in 1991.
- (2) Represents the interest income earned on the health insurance reserve.
- (3) Represents the amount associated with the risk factor built in the cost plus formula.
- (4) Represents the overcharge for the personal usage of the corporate automobile.
- (5) Represents unreasonable executive compensation increases.
- (6) Represents various expenses that are unallowable.

**ARKANSAS-LOUISIANA BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - LA PART B
FOR THE PERIOD OCTOBER 1, 1991 THROUGH SEPTEMBER 30, 1992**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$15,912,028</u>	
FACP Costs Claimed		
Claims Payment	\$ 9,569,385	
Reviews and Hearings	1,100,958	
Beneficiary/Physician Inquiry	1,476,930	
Professional Relations	186,119	
Medical Review & Utilization Review	1,614,649	
Medicare Secondary Payer	727,301	
Participating Physician	328,582	
Productivity Investments	808,304	
Other	-	
Physician Incentive Bonus	99,800	
Other	-	
Total FACP Costs Claimed	<u>\$15,912,028</u>	
Less Recommended Adjustments:		
Interest HMO	5,097	1
Contingency Reserve	6,002	2
Executive Compensation Costs	14,321	3
Miscellaneous Unallowable Costs	<u>1,171</u>	4
Total Recommended Adjustment	<u>26,591</u>	*
Total Costs Recommended for Acceptance	<u>\$15,885,437</u>	

Note:

- (1) Represents the interest income earned on the health insurance reserve.
- (2) Represents the amount associated with the risk factor built in the cost plus formula.
- (3) Represents unreasonable executive compensation increases.
- (4) Represents various expenses that are unallowable.

* We did not offset questioned costs by the \$25,938 complimentary credit overcharge.

**ARKANSAS-LOUISIANA BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - LA PART B
FOR THE PERIOD OCTOBER 1, 1992 THROUGH SEPTEMBER 30, 1993**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$15,855,891</u>	
FACP Costs Claimed		
Claims Payment	\$ 9,248,715	
Reviews and Hearings	1,115,951	
Beneficiary/Physician Inquiry	1,413,330	
Provider Education & Training	191,918	
Medical Review & Utilization Review	1,556,257	
Medicare Secondary Payer	746,129	
Participating Physician	325,724	
Productivity Investments	740,506	
Other	-	
Fraud & Abuse	351,956	
Physician Incentive Bonus/Special MR Project	<u>165,405</u>	
Total FACP Costs Claimed	<u>\$15,855,891</u>	
Less Recommended Adjustments:		
Interest HMO	5,416	1
Contingency Reserve	8,029	2
Executive Compensation Costs	<u>26,523</u>	3
Total Recommended Adjustment	<u>39,968</u>	
Total Costs Recommended for Acceptance	<u>\$15,815,923</u>	

Note:

- (1) Represents the interest income earned on the health insurance reserve.
- (2) Represents the amount associated with the risk factor built in the cost plus formula.
- (3) Represents unreasonable executive compensation increases.

**ARKANSAS-LOUISIANA BLUE SHIELD
FINAL ADMINISTRATIVE COST PROPOSAL
AND THE AUDITOR'S RECOMMENDATIONS - LA PART B
FOR THE PERIOD OCTOBER 1, 1993 THROUGH SEPTEMBER 30, 1994**

<u>Operation</u>	<u>Administrative Costs</u>	<u>Note</u>
Total Budget	<u>\$14,613,107</u>	
FACP Costs Claimed		
Claims Payment	\$ 8,090,609	
Reviews and Hearings	1,094,853	
Beneficiary/Physician Inquiry	1,476,402	
Provider Education & Training	715,196	
Medical Review & Utilization Review	1,351,752	
Medicare Secondary Payer	835,306	
Participating Physician	392,192	
Productivity Investments	136,462	
Other	-	
Benefit Integrity	385,372	
Other	<u>134,963</u>	
Total FACP Costs Claimed	<u>\$14,613,107</u>	
Less Recommended Adjustments:		
Interest HMO	10,276	1
Contingency Reserve	6,264	2
Executive Compensation Costs	43,700	3
Miscellaneous Unallowable Costs	<u>346</u>	4
Total Recommended Adjustment	<u>60,586</u>	
Total Costs Recommended for Acceptance	<u>\$14,552,521</u>	

Note:

- (1) Represents the interest income earned on the health insurance reserve.
- (2) Represents the amount associated with the risk factor built in the cost plus formula.
- (3) Represents unreasonable executive compensation increases.
- (4) Represents various expenses that are unallowable.

**Report on the Audit of Administrative Costs
Incurred Under Part B - Louisiana
Incurred Under Parts A & B - Arkansas
The Health Insurance for the Aged
and Disabled Program**

**ARKANSAS BLUE CROSS BLUE SHIELD
Exit Conference**

Attendees

David Greenwood - Govnm't Programs Acctg. Manager
Beverly Villines - Accounting Manager
Charles G. Clems - V.P. Government Programs
Mary Duff Biggs - Auditor

Firm

ARK-BCBS
ARK-BCBS
ARK-BCBS
Doshi & Associates, P.C.

**ARKANSAS BLUE CROSS BLUE SHIELD
RESPONSE**



Arkansas
Blue Cross Blue Shield

601 Gaines
P.O. Box 2181
Little Rock, Arkansas 72203-2181

June 14, 1996

Mr. Bill Anderson
Doshi and Associates, P.C.
4520 Madison, Suite 105
Kansas City, MO 64111

Dear Bill:

Attached is the Arkansas Blue Cross Blue Shield (ABCBS) response to specific findings in the "Draft" Audit Report issued May 14, 1996 by "Doshi and Associates, P.C.". As detailed in the attached response, we are questioning the \$228,396 finding on excessive executive compensation as well as \$186,782 of the findings related to the two insurance issues. There are calculation issues related to these findings which may require further discussion.

We would like the final audit report to include our request that all of the fiscal 1993 and 1994 findings be offset by allowable overhead costs which were not filed due to Bottom Line Unit Cost limitations in those years. We have written communications from the Dallas Regional Office of the Health Care Financing Administration (HCFA) stating that such a request would be allowed.

We would also request that the 1992 audit findings be offset by the excess crossover credits collected and credited to the Medicare Programs in that year. In fiscal 1989, 1990 and 1991 there are audit findings for crossover credits because the rate charged was below apportionable cost. In 1992, the rate used exceeded apportionable cost due to a calculation error. Since ABCBS will be unable to collect the deficiency related to the first three years of the audit, we request that the excess credits collected in 1992 be used to offset 1992 findings.

We appreciate the professionalism shown by your audit staff in conducting the audit review and hope for a quick conclusion to the remaining audit process. Please contact either David Greenwood or myself if we can answer any questions or concerns related to our response.

Sincerely,

A handwritten signature in cursive script that reads "Beverly".

Beverly Villines
Director, Corporate Accounting
Arkansas Blue Cross Blue Shield

ARKANSAS BLUE CROSS AND BLUE SHIELD

HMO ARKANSAS HEALTH INSURANCE

ABCBS RECOMMENDATIONS

THE EXPERIENCE PERIODS REFLECTED IN THE DATA PREPARED BY THE ACTUARIAL & UNDERWRITING DEPARTMENTS CONTAINS OVERLAPPING MONTHS AND THUS DISTORTS THE "RESERVE BALANCE" TO SOME EXTENT.

THE ADMINISTRATIVE EXPENSE/RETENTION FACTOR USED FOR THIS PRODUCT WAS 12% PER THE ACTUARIAL & UNDERWRITING DEPARTMENTS.

THE RATIO USED FOR LOUISIANA PART B, IN 1989 - 1991 FOR C/C 066 (WHICH WAS USED AS MOST CLOSELY MATCHING THE NEEDED ALLOCATION METHOD; i.e., W/O LA ON-SITE PERSONNEL) REFLECTED AN LA B % WHICH WAS GREATER THAN THE CORPORATE SALARY-DOLLAR RATIO (LOB 410) WHICH INCLUDED THE LA ON-SITE STAFF AS WELL. FOR THOSE YEARS, A 50% FACTOR WAS APPLIED TO BRING THIS INTO LINE WITH ACTUAL AMOUNTS. C/C 066 - CORPORATE SPACE PLANNER INCLUDED DIRECT LOUISIANA TIME IN HIS ALLOCATION AS A RESULT OF EXTENSIVE WORK DONE ON-SITE IN LOUISIANA DURING LATE 1990 AND 1991 RELATIVE TO LEASING NEW SPACE AND PREPARING THE LAYOUTS, ORDERING FURNITURE, RELOCATING FURNITURE FROM LITTLE ROCK AND CONFIGURING SAME.

IT SHOULD BE NOTED THAT THE INCREASE BETWEEN 1989 AND 1990 REFLECTS THE ADDITION TO ABCBS PAYROLL OF CLERICAL POSITIONS PREVIOUSLY SUBCONTRACTED WITH LOUISIANA BLUE CROSS AND BLUE SHIELD.

ARKANSAS BLUE CROSS AND BLUE SHIELD
MEDICARE DRAFT AUDIT RESPONSE
FY 1989 - FY 1994

These comments are in response to the "Draft" Audit Report issued by Doshi & Associates, P.C., dated May 14, 1996. The responses are in the order presented and, where information not previously presented is given, it will be noted in bold italics.

EMPLOYEE HEALTH INSURANCE

- HMO GROUP PLAN: Additional research and follow-up on this audit finding confirmed that the claims expense per the schedule given the audit team did not, in fact, include administrative expenses for the plan. The retention factors have been provided by the Actuarial staff and these have been applied to the claims amounts to determine the "net income" added to reserves for this group. Further, this amount has been confirmed in total by the Actuarial staff.

At the time this insurance coverage was provided as an option to employees, the "related-party" relationship was inadvertently over-looked. In fact, we were more consciously wanting to avoid any sense of impropriety by ensuring that an "arms length" transaction took place relative to the marketplace.

We are in agreement that the amount of cost allowed should be limited to the actual experience including administrative expenses and, therefore, offer our own calculation of the amount of the reserve balance for our group as well as the amount of interest which would have accrued to the enterprise for that reserve balance.

I have noted on the worksheet recalculating the amount of interest that the cost center which was used (as most closely reflecting the allocation method needed) was not, in fact, the most appropriate. During late 1990 and in 1991, the allocation in this cost center (Space Planner) reflected direct time spent in configuring new space on-site in Louisiana and managing the relocation of furnishings, etc. This is confirmed by the fact that the percentage allocated to Louisiana Part B exceeds in those years the overall corporate salary-dollar ration for the LA program. Consequently, we are proposing to use a 50 percent factor against the total Louisiana B salaries; in more recent years, this is around 35 - 40%.

Please reference the attached spreadsheet for the revised Interest on Reserve Balance calculation.

- PPO GROUP INSURANCE: We agree with the amounts presented in the DRAFT with the exception of FY 1994. Doshi & Associates included our earlier feed back on this finding showing that the allocation to LOB used in the initial calculation incorrectly excluded the subsidiaries as part of the Cost Plus group. At a later date, we provided information regarding the settlement of costs for the 1994 plan year. This latter data was not included in the DRAFT. A copy of the schedule - with 1994 highlighted - is attached for further review and inclusion in the final report. The impact is minor but is a more accurate reflection of the actual costs incurred.

In summary, the total questioned costs is \$186,782 for these two insurance issues.

EXECUTIVE COMPENSATION

The auditors used the Bureau of Labor Statistics' Executive Compensation Index (ECI) to assess the reasonableness of top executive compensation increases during the years audited using as a baseline FY 1990 actual salaries including incentive pay and "non-cash", taxable benefits such as personal mileage, life insurance policies, etc. There are some components of the calculation itself with which we take exception relative to whether the amounts were, in fact, charged to the government programs via the FACP. Further, the audit indicates that the comparisons are exclusive of promotions. In most instances, for this classification of staff, where job duties have changed significantly, the corresponding salary adjustment was made at the time of the routine merit increase. Further research will be required to determine to distribution of the increase between these two factors.

Our stronger disagreement relates to the general comparison of the health insurance industry with other industrial companies. The competitiveness in the health insurance industry has accelerated greatly in the past few years as has the complexity of the Medicare program management particularly as it relates to developing creative ways to provide more required services at lower administrative costs. Additionally, the requirements to maintain the highest management and strategic planning skills, staff and financial resource needs, etc. in support of the emerging managed care environment make a comparison to "any and all" executive, administrative and managerial positions generically, regardless of size, complexity or the industry itself somewhat misleading.

Our salary levels have been recommended by Hay Management Company based on the job requirements and relative to the banking and finance industry specifically.

As job duties change, increases for both merit pay and promotion to enhanced positions have been made. Often times, these increases are combined so the distinction between the two is not readily available.

Information from sources such as the Hay Management Group and Hewitt Associates indicates a higher increase rate for executives in the insurance industry than does the ECI; nearer 20% during the audit time period.

We believe that some of the one-time incentive or bonus payments should not be considered in calculating the cumulative increase percentage. It is our further belief that the executive compensation is very reasonable in our particular industry and environment.

If necessary, we will offer additional information which further supports the charges we made to the Medicare programs considering coding changes for certain incentive payments which were assumed to be allocated on the same basis as regular, base salaries as well as for costs which were actually excluded from the FACP during the years when Medicare budget limitations caused us to limit the amount of corporate overhead charged. The impact of the latter issue (apparently a misunderstanding occurred during the discussion of these limits) is a reduction in the amount in question of \$66,000 and another estimated \$45,000 related to the incentive coding issue.

PERSONAL USE OF CORPORATE AUTO

We are in agreement with this finding and will adjust the applicable Final Administrative Cost Proposal (FACP) to exclude the proposed amounts totaling \$134,428. As noted in the DRAFT, procedures have been in place since the previous audit to ensure that these costs are excluded from the FACP.

MISCELLANEOUS UNALLOWABLE COSTS

- BANK ACCOUNT SERVICE FEES: We are in agreement with this finding and will adjust the applicable FACP to exclude these fees totaling \$27,469.

- ANNUAL REPORTS: We are in agreement with this finding and will adjust the applicable FACP to exclude these annual report publication charges totaling \$23,885.

- LEGAL FEES: We are in agreement with this finding and will adjust the applicable FACP to exclude these legal charges of \$3,690.

- STATE LICENSING REQUIREMENT: We are in agreement with this finding and will adjust the applicable FACP to exclude these minor allocation/coding errors totaling \$1,844.

- SOCIAL ACTIVITY: We are in agreement with this finding and will adjust the applicable FACP to exclude these minor coding errors totaling \$530.

- POLLOR LINE CHARGES: We are in agreement with this finding and will adjust the applicable FACP to exclude these minor allocation errors totaling \$1;344.

RETENTION OF SUPPORTING DOCUMENTATION

We appreciate the input provided by the audit staff regarding our documentation process. During 1996, we have staffed a section within our Government Programs Accounting division to support a variety of compliance issues for the government contracts. Included in this section are functions which will support the improvement (and establishment where needed) of our internal documentation relative to Financial Policies and Procedures which will impact all products and services of the Enterprise. Other specific documentation reviews will also be conducted such as those noted in the DRAFT. We believe that the end results of this activity will be visible in our daily operations as well as in future audits.

**ARKANSAS BLUE CROSS AND BLUE SHIELD
COMP MAJOR MEDICAL / PPO HEALTH INSURANCE
ABCBS RECOMMENDATIONS**

SETTLEMENT / AUDIT PERIOD	CLAIMS PAID less	RISK FACTOR	CONTINGENCY	MEDICARE PERCENTAGE			MEDICARE QUESTIONED COST		
	LARGE CLAIMS		AMOUNT	AR A	AR B	LA B	AR A	AR B	LA B
SETTLEMENT PERIOD 03/89 - 02/90	1,680,032								
USE FOR FY 1989	0								
NET CLAIMS PAID	1,680,032	1.1%	18,480.36	6.6208%	13.6091%	10.2198%	1,223.56	2,515.01	1,888.66
SETTLEMENT PERIOD 03/90 - 02/91	2,440,459								
USE FOR FY 1990	(22,145)								
NET CLAIMS PAID	2,462,604	1.1%	27,088.65	6.5264%	14.2576%	16.0438%	1,767.92	3,862.19	4,346.06
SETTLEMENT PERIOD 03/91 - 02/92	2,556,339								
USE FOR FY 1991	(148,757)								
NET CLAIMS PAID	2,705,095	1.1%	29,756.05	3.6511%	11.3635%	13.4565%	1,086.42	3,381.34	4,004.11
SETTLEMENT PERIOD 03/92 - 12/92	2,327,027								
USE FOR FY 1992	(46,003)								
NET CLAIMS PAID	2,373,030	1.6%	37,968.48	6.3576%	12.1436%	15.8073%	2,413.89	4,610.73	6,001.80
SETTLEMENT PERIOD 01/93 - 12/93	3,194,782								
USE FOR FY 1993	(246,360)								
NET CLAIMS PAID	3,441,142	1.6%	55,058.28	5.7253%	11.3479%	14.5822%	3,152.24	6,247.94	8,028.69
SUBTOTAL 1989 - 1993							9,644.03	20,617.21	24,269.32
SETTLEMENT PERIOD 01/94 - 12/94	2,494,516								
USE FOR FY 1994	(94,559)								
NET CLAIMS PAID	2,589,075	1.6%	41,425.20	5.2237%	11.3192%	15.1221%	2,163.93	4,689.02	6,264.37
TOTAL ALL YEARS							11,807.96	25,306.23	30,533.69

ARKANSAS BLUE CROSS AND BLUE SHIELD
HMO ARKANSAS HEALTH INSURANCE
ABCBS RECOMMENDATIONS

SETTLEMENT / AUDIT PERIOD	CLAIMS PAID less LARGE CLAIMS	ACCUM RESERVE	AVERAGE ACCUM RESERVE *	ROI %	INTEREST ON REVENUE	MEDICARE PERCENTAGE AR A AR B LA B	MEDICARE QUESTIONED COST AR A AR B LA B
USE FOR FY 1989	1,610,504						
ADJUSTED INCOME	839,180						
CLAIMS EXPENSE	100,702	670,622	335,311	7.6400%	25,618	8.1700% 16.3200% 6.0800%	2,092.97 4,180.82 1,557.56
ADMINISTRATIVE EXPENSE							
USE FOR FY 1990							
ADJUSTED INCOME	2,258,172						
CLAIMS EXPENSE	1,656,627	402,750					
ADMINISTRATIVE EXPENSE	198,795	1,073,372	871,997	7.8100%	68,103	6.5264% 14.2576% 9.5400%	4,444.70 9,709.85 6,497.03
USE FOR FY 1991							
ADJUSTED INCOME	2,479,856						
CLAIMS EXPENSE	2,416,967	(227,047)					
ADMINISTRATIVE EXPENSE	290,036	846,325	959,849	7.0000%	67,189	3.6511% 11.3635% 8.0400%	2,453.15 7,635.10 5,402.03
USE FOR FY 1992							
ADJUSTED INCOME	3,006,005						
CLAIMS EXPENSE	2,413,503	302,882					
ADMINISTRATIVE EXPENSE	289,620	1,149,207	997,766	5.8300%	58,170	6.3576% 12.1436% 7.2000%	3,698.21 7,063.89 4,188.22
USE FOR FY 1993							
ADJUSTED INCOME	3,419,407						
CLAIMS EXPENSE	2,330,509	809,237					
ADMINISTRATIVE EXPENSE	279,661	1,958,444	1,553,825	4.4300%	68,834	5.7253% 11.3479% 6.6800%	3,940.97 7,811.24 4,598.14
USE FOR FY 1994							
ADJUSTED INCOME	3,819,878						
CLAIMS EXPENSE	2,214,273	1,339,892					
ADMINISTRATIVE EXPENSE	265,713	3,298,336	2,628,390	4.6800%	123,009	5.2237% 11.3192% 7.5600%	6,425.59 13,923.65 9,299.45
TOTAL ALL YEARS							23,055.59 50,324.55 31,542.43



Arkansas
BlueCross BlueShield

601 Gaines
P.O. Box 2181
Little Rock, Arkansas 72203-2181

June 20, 1996

Mr. Bill Anderson
Doshi and Associates, P.C.
4520 Madison, Suite 105
Kansas City, MO 64111

Dear Bill:

The cover letter on the Arkansas Blue Cross Blue Shield (ABCBS) response to "Draft" Audit Report dated June 14, 1996 contains an error in the first paragraph. The amount we question on the health insurance findings, as supported by the schedules we submitted, is \$172,571 instead of the \$186,782 cited in the first paragraph.

Please consider this an amendment to our original response and I trust this clears up any confusion regarding the adjustments we are requesting. If you have further questions or concerns please contact either Beverly Villines or myself.

Sincerely,

A handwritten signature in cursive script that reads "David F. Greenwood".

David F. Greenwood
Manager, Government Programs Accounting
Arkansas Blue Cross Blue Shield



Arkansas
BlueCross BlueShield

601 Gaines
P.O. Box 2181
Fayette Rock, Arkansas 72205-2181

July 1, 1996

Mr. Bill Anderson
Doshi and Associates, P.C.
4520 Madison, Suite 105
Kansas City, MO 64111

Dear Bill:

I talked to the Actuarial department in search of support for their assertion that administrative costs approximated 12% of the level of claims expense. There appears to be no actual data to back up this estimate. I have therefore utilized the financial statements for 1989 - 1993 for HMO Arkansas and the 1994 statement for HMO Partners, Inc. to develop the percentages.

I have attached copies of the Income Statements which are broken down into business segments. From these I have calculated the following percentages:

	<u>Operating Expenses</u>	<u>Benefit Payments</u>	<u>Percentage</u>
1989	\$1,260,146	\$15,416,573	8.17%
1990	1,301,545	16,306,008	7.98
1991	1,470,398	17,083,964	8.61
1992	1,865,308	20,656,479	9.03
1993	1,998,695	20,124,308	9.93
1994	6,449,551	45,441,961	14.19

Based on these percentages, I have recalculated the schedule showing the interest earned on the reserves associated with the employee group, and the portion applicable to the Medicare Programs. The new schedule shows interest income to be credited to the Medicare Programs increases \$13,540 over our previous calculation.

Please let me know if you find this methodology appropriate. If more information is required I will attempt to provide it. I have also attached a schedule showing our interpretation of the audit findings taking into consideration the adjustments we have proposed.

Sincerely,

David F. Greenwood
Manager, Government Programs Accounting
Arkansas Blue Cross Blue Shield

**Medicare Audit Findings
Audit Draft Report**

	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>Total</u>
Complimentary Insurance Credits	\$351,233	\$320,799	\$159,805		\$2,749		\$834,586
HMO Group Ins - Int on Reserves	10,469	33,088	41,308	33,041	37,657	56,504	212,067
PPO Group Ins - Risk Cost	5,628	9,976	8,471	13,027	17,429	14,520	69,051
Exec Compensation Costs			11,280	43,999	65,659	107,458	228,396
Personal Use of Corp Autos	39,373	40,959	54,096				134,428
Miscellaneous Findings	6,937	30,957	17,683	2,386		799	58,762
Total	\$413,640	\$435,779	\$292,643	\$92,453	\$123,494	\$179,281	\$1,537,290

**Medicare Audit Findings
After Proposed Adjustments to Draft Report**

	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>Total</u>
Complimentary Insurance Credits	\$351,233	\$320,799	\$159,805		\$2,749		\$834,586
HMO Group Ins - Int on Reserves	8,207	22,202	17,744	18,195	19,259	32,766	118,373
PPO Group Ins - Risk Cost	5,628	9,976	8,471	13,027	17,429	13,117	67,648
Exec Compensation Costs							0
Personal Use of Corp Autos	39,373	40,959	54,096				134,428
Miscellaneous Findings	6,937	30,957	17,683	2,386		799	58,762
Adj for Overcharged Credits				(33,608)			(33,608)
Adj for Unfiled Overhead					(39,437)	(46,682)	(86,119)
Total	\$411,378	\$424,893	\$257,799	\$0	\$0	\$0	\$1,094,070

ARKANSAS BLUE CROSS AND BLUE SHIELD
HMO ARKANSAS HEALTH INSURANCE
ABCBS RECOMMENDATIONS

SETTLEMENT / AUDIT PERIOD	CLAIMS PAID less	ACCUM	AVERAGE ACCUM	ROI %	INTEREST	MEDICARE PERCENTAGE			MEDICARE QUESTIONED COST		
	LARGE CLAIMS	RESERVE	RESERVE "		ON REVENUE	AR A	AR B	LA B	AR A	AR B	LA B
USE FOR FY 1989											
ADJUSTED INCOME	1,610,504										
CLAIMS EXPENSE	839,180										
ADMINISTRATIVE EXPENSE	68,561	702,763	351,381	7.6400%	26,846	8.1700%	16.3200%	6.0800%	2,193.28	4,381.19	1,632.21
USE FOR FY 1990											
ADJUSTED INCOME	2,258,172										
CLAIMS EXPENSE	1,656,627										
ADMINISTRATIVE EXPENSE	132,199	469,346									
		1,172,109	937,436	7.8100%	73,214	6.5264%	14.2576%	9.5400%	4,778.25	10,438.52	6,984.59
USE FOR FY 1991											
ADJUSTED INCOME	2,479,956										
CLAIMS EXPENSE	2,416,967										
ADMINISTRATIVE EXPENSE	208,101	(145,112)									
		1,026,997	1,099,553	7.0000%	76,969	3.6511%	11.3635%	8.0400%	2,810.20	8,746.38	6,188.29
USE FOR FY 1992											
ADJUSTED INCOME	3,006,005										
CLAIMS EXPENSE	2,413,503										
ADMINISTRATIVE EXPENSE	217,939	374,563									
		1,401,560	1,214,279	5.8300%	70,792	6.3576%	12.1436%	7.2000%	4,500.71	8,596.73	5,097.06
USE FOR FY 1993											
ADJUSTED INCOME	3,419,407										
CLAIMS EXPENSE	2,330,509										
ADMINISTRATIVE EXPENSE	231,420	857,478									
		2,259,038	1,830,299	4.4300%	81,082	5.7253%	11.3479%	6.6800%	4,642.19	9,201.10	5,416.29
USE FOR FY 1994											
ADJUSTED INCOME	3,819,878										
CLAIMS EXPENSE	2,214,273										
ADMINISTRATIVE EXPENSE	314,205	1,291,400									
		3,550,438	2,904,738	4.6800%	135,942	5.2237%	11.3192%	7.5600%	7,101.18	15,387.58	10,277.20
TOTAL ALL YEARS									26,025.81	56,751.51	35,595.63

USABLE CORPORATION AND SUBSIDIARIES
(A Wholly-Owned Subsidiary of Arkansas Blue Cross and Blue Shield)

Consolidating Statement of Earnings (Loss)
and Retained Earnings (Deficit)

For the Year Ended December 31, 1989

		<u>HMO</u>
Revenues:		
Premiums, net of reinsurance	\$	15,840,015
Software installation and consulting fees		-
Investment income		154,693
Fees for administrative services		-
Reinsurance recovery		682,011
Computer rentals and gross profit on sales		-
Other		-
Total revenues		<u>16,676,719</u>
Operating costs:		
Death, health and accident and health benefits, net of reinsurance		15,416,573
Operating expenses		<u>1,260,146</u>
Total operating costs		<u>16,576,719</u>
Earnings (loss) from continuing operations before income tax and equity in earnings of subsidiaries		-
Provision (credit) for income taxes		-
Earnings (loss) from continuing operations before equity in earnings of subsidiaries		-
Equity in earnings (loss) of subsidiaries		-
Net earnings (loss) from continuing operations		-
Discontinued operations:		
Earnings (loss) from operations of discontinued operations, net of income tax benefit		-
Gain (loss) on disposal of discontinued operations, net of income tax expense		-
Earnings (loss) from discontinued operations		-
Net earnings (loss)		-
Retained earnings (deficit), beginning of year		(1,867,361)
Dividends paid		-
Dissolution of subsidiary		-
Retained earnings (deficit), end of year	\$	<u>(1,867,361)</u>

(A Wholly-Owned Subsidiary of Arkansas Blue Cross and Blue Shield)

Consolidating Statement of Earnings (Loss)
and Retained Earnings (Deficit)

For the Year Ended December 31, 1990

	<u>HMO</u> <u>Arkansas</u>
Revenues:	
Premiums, net of reinsurance	\$ 17,354,965
Software installation and consulting fees	-
Investment income	162,926
Fees for administrative services	-
Reinsurance recovery	(284,321)
Computer rentals and gross profit on sales	-
Other	<u>3,730</u>
Total revenues	<u>17,237,300</u>
Operating costs:	
Death, health and accident and health benefits, net of reinsurance	16,306,008
Operating expenses	<u>1,301,545</u>
Total operating costs	<u>17,607,553</u>
Earnings (loss) from continuing operations before income tax and equity in earnings of subsidiaries	(370,253)
Provision (credit) for income taxes	<u>(370,253)</u>
Earnings before equity in earnings of subsidiaries	-
Equity in earnings of subsidiaries	<u>-</u>
Net earnings	-
Retained earnings (deficit), beginning of year	(1,867,361)
Dividends paid	<u>-</u>
Retained earnings (deficit), end of year	<u>(1,867,361)</u>

(A Wholly-Owned Subsidiary of Arkansas Blue Cross
and Blue Shield, A Mutual Insurance Company)

Consolidating Statement of Earnings (Loss)
and Retained Earnings (Deficit)

For the Year Ended December 31, 1991

	HMO <u>Arkansas</u>
Revenues:	
Premiums, net of reinsurance	18,832,627
Health benefit review, implementation, and management services	-
Administrative services	-
Software installation and consulting fees	-
Investment income	144,507
Other	(106,122)
Total revenues	<u>18,871,012</u>
Operating costs:	
Death, health and, accident and health benefits	17,083,964
Operating expenses	<u>1,470,398</u>
Total operating costs	<u>18,554,362</u>
Minority interest in earnings of subsidiary	-
Earnings (loss) before provision for income tax, equity in earnings of subsidiaries and cumulative effect of change in accounting principle	316,650
Provision (credit) for income taxes	<u>41,650</u>
Earnings (loss) before equity in earnings of subsidiaries and cumulative effect of change in accounting principle	275,000
Equity in earnings of subsidiaries	-
Earnings before cumulative effect of change in accounting principle	275,000
Cumulative effect of change in accounting principle	<u>(275,000)</u>
Net earnings (loss)	-
Retained earnings (deficit), beginning of year	(1,867,361)
Dividends paid	-
Retained earnings (deficit), end of year	<u>(1,867,361)</u>

USABLE CORPORATION AND SUBSIDIARIES
(A Wholly-Owned Subsidiary of Arkansas Blue Cross
and Blue Shield, A Mutual Insurance Company)

Consolidating Statement of Earnings (Loss)
and Retained Earnings (Deficit)

For the Year Ended December 31, 1992

	HMO Arkansas
Revenues:	
Premiums, net of reinsurance	22,817,545
Software installation and consulting	-
Administrative services	-
Investment income	117,748
Other	(336,227)
Total revenues	<u>22,599,066</u>
Operating costs:	
Death, accident and health benefits, net of reinsurance recovery	20,636,479
Operating expenses	1,865,308
Total operating costs	<u>22,521,787</u>
Earnings (loss) from continuing operations before provision for income tax and equity in earnings of subsidiaries	77,279
Provision (credit) for income taxes	<u>77,279</u>
Earnings (loss) from continuing operations before equity in earnings of subsidiaries	-
Equity in earnings of subsidiaries	-
Earnings from continuing operations	-
Discontinued operations:	
Net income (loss) of discontinued subsidiary, net of income tax expense of \$11,488	-
Minority interest in net (earnings) loss of discontinuing subsidiary	-
Net earnings (loss)	-
Retained earnings (deficit), beginning of year	(1,867,361)
Dividends paid	-
Retained earnings (deficit), end of year	<u>(1,867,361)</u>

USable CORPORATION AND SUBSIDIARIES
(A Wholly-Owned Subsidiary of Arkansas Blue Cross
and Blue Shield, A Mutual Insurance Company)

Consolidating Statement of Earnings (Loss)
and Retained Earnings (Deficit)

For the Year Ended December 31, 1993

Schedule 2

		<u>HMO</u> <u>Arkansas</u>
Revenues:		
Premiums, net of reinsurance	\$	27,134,585
Software installation and consulting		-
Administrative services		-
Investment income		131,714
Gain on sale of subsidiary		-
Other		(1,622,864)
Total revenues		<u>25,643,435</u>
Operating costs:		
Death, accident and health benefits		20,124,308
Operating expenses		<u>1,998,695</u>
Total operating costs		<u>22,123,003</u>
Earnings (loss) before provision for income tax and equity in earnings of subsidiaries		3,520,432
Provision (credit) for income taxes		<u>1,205,970</u>
Earnings (loss) before equity in earnings of subsidiaries		2,314,462
Equity in earnings of subsidiaries		<u>-</u>
Net earnings (loss)		2,314,462
Retained earnings (deficit), beginning of year		(1,867,361)
Dividends paid		<u>-</u>
Retained earnings (deficit), end of year	\$	<u>447,101</u>

HMO PARTNERS, INC.
STATEMENT OF INCOME
YEAR ENDED DECEMBER 31, 1994

PREMIUM REVENUES	\$ <u>52,852,322</u>
OPERATING EXPENSES	
Medical expenses	
Medical services	41,488,255
Capitation fees	4,871,943
Excess medical expenses (Note 2)	<u>(918,237)</u>
	<u>45,441,961</u>
General and administrative expenses	
Employee salaries and benefits	3,295,541
Advertising and printing	757,890
Rent	201,361
Other	<u>2,194,759</u>
	<u>6,449,551</u>
INCOME FROM OPERATIONS	<u>960,810</u>
OTHER INCOME (EXPENSE)	
Interest income	399,755
Interest expense	(156,166)
Other income	<u>142,583</u>
	<u>386,172</u>
INCOME BEFORE TAXES	1,346,982
PROVISION FOR INCOME TAXES (Note 8)	<u>550,000</u>
NET INCOME	\$ <u><u>796,982</u></u>

See Notes to Financial Statements