DEPARTMENT OF HEALTH & HUMAN SERVICES — Office of Inspector General

Memorandum

Date FEB 4 1998

From June Gibbs Brown
Inspector General

Subject Audit of Administrative Costs Claimed Under Parts A & B of the Health Insurance for the Aged and Disabled Program - Associated Insurance Companies, Inc., Indianapolis, Indiana (A-05-97-00005)

To Nancy-Ann Min DeParle
Administrator
Health Care Financing Administration

This memorandum is to alert you to the issuance on Friday, February 6, 1998, of our final report. A copy is attached.

The audit covered the costs claimed by Associated Insurance Companies (AIC) on final administrative cost proposals for Fiscal Years 1994 through 1995. Costs audited included Medicare Part A, Part B, and durable medical equipment claims (DMERC).

Our audit results show that a financial adjustment of $2,542,067 ($525,962 for Part A, $975,239 for Part B, and $1,040,866 for DMERC) is needed to reduce the claimed costs. Some examples of the reasons the adjustments are necessary are because Associated:

- understated complementary insurance credits by $934,382. Charges to complementary insurers did not include cost allocations from all cost centers that supported claims processing activities.

- claimed executive salary increases of $182,337 which exceeded the average increases for comparable positions, as measured by the Federal Bureau of Labor Statistics.

- charged pension costs of $46,388 to Medicare based on accrual accounting entries instead of actual cash contributions.

- charged $153,324 of deferred compensation costs to Medicare based on accrual accounting entries instead of actual cash contributions. An additional $240,733 was charged for premiums on employee insurance policies which listed the company as beneficiary.

- claimed $76,550 of indirect cost allocations that were for non-Medicare related costs. An additional $449,212 were for estimated costs that were claimed that exceeded actual costs.

- overstated return of investment by $203,689 because amounts were inconsistently calculated between fiscal years.

- claimed $187,404 of post-retirement benefit costs based on accrual accounting entries instead of actual cash contributions.

In response to our draft report, AIC concurred with $83,272 of our recommended financial adjustments and disagreed with the remaining amounts questioned. After considering their response, we continue to believe a negative adjustment of $2,542,067 is necessary.

For further information, your staff should contact:

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

Attachment

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

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

ASSOCIATED INSURANCE COMPANIES, INC. INDIANAPOLIS, INDIANA

JUNE GIBBS BROWN
Inspector General

FEBRUARY 1998
A-05-97-00005

DEPARTMENT OF HEALTH AND HUMAN SERVICES
REGION V
105 W. ADAMS ST.
CHICAGO, ILLINOIS 60603-6201

OFFICE OF
INSPECTOR GENERAL

Common Identification No. A-05-97-00005

Mr. Stephen T. Crickmore
President & CEO, AdminaStar Federal
AdminaStar, Inc.
6801 Hillsdale Court
Indianapolis, IN 46250

Dear Mr. Crickmore:

Enclosed for your information and use are two copies of an Office of Inspector General (OIG) audit report entitled, "Audit of Administrative Costs Claimed Under Parts A & B of the Health Insurance for the Aged and Disabled Program." The audit covered the period October 1, 1993 through September 30, 1995. A copy of this report will be forwarded to the HHS action official named below, for her review and any action deemed necessary.

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

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

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

Sincerely,

Paul Swanson

Paul Swanson
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to:
Ms. Daly Vargas
Associate Regional Administrator
Division of Medicare

SUMMARY

Associated Insurance Companies, Inc. (AIC), receives, reviews, audits, and pays both Medicare Parts A, B, and DMERC claims under agreements with Blue Cross and Blue Shield Association and the Health Care Financing Administration. The AIC is entitled to reimbursement for its allowable administrative costs incurred. Effective in 1996, AIC changed its corporate name to Anthem. For the period October 1, 1993 through September 30, 1995, AIC claimed administrative costs, for Medicare Parts A and B, as follows:

Fiscal Year	Part A	Part B	DMERC	Total
1994	$ 7,964,844	$18,329,073	$14,689,560	$40,983,477
1995	8,433,824	18,604,312	19,028,706	46,066,842
Total	$16,398,668	$36,933,385	$33,718,266	$87,050,319

Of the $87,050,319 in administrative costs claimed, we are recommending financial adjustments of $525,962 (Part A), $975,239 (Part B), and $1,040,866 (DMERC). These amounts are detailed in the Exhibits and the Findings and Recommendations section of the report.

We found that Medicare costs were overstated because:

- Complementary insurance credits were understated by $934,382 because AIC's charges to complementary insurers did not include cost allocations from all cost centers that support claims processing activities.

- Indirect cost allocations of $449,212 were estimates exceeding actual costs incurred. Additional indirect costs questioned of $76,550 were non-Medicare related costs.

- Deferred compensation costs of $153,324 were based on accrual accounting entries instead of actual cash contributions. Additional deferred compensation costs of $240,733 were for premiums of employee life insurance policies. AIC is the beneficiary on the policies and insurance proceeds are not restricted for use as deferred compensation.

- Return on investment costs of $203,689 were not calculated in accordance with the Medicare contracts. The net book value of assets was inconsistently calculated each fiscal year, and the actual rate of return formulas utilized by AIC were not in accordance with Medicare guidelines.

- Post-retirement health benefits costs of $187,404 were based on accrual accounting entries instead of actual cash contributions.

- Salary increases for selected AIC executives exceeded average increases for comparable positions, as measured by the Federal Bureau of Labor Statistics (ECI) index, by $182,337.

- Pension costs of $46,388 were charged to Medicare based on accrual accounting entries instead of actual cash contributions.

- Interest costs of $22,837 were charged to Medicare. Federal regulations do not allow interest costs on borrowings.

- Professional consultant costs of $15,206 were for unsupported retainer fees charged to Medicare. Additional consultant costs of $4,195 exceeded the $50 hourly rate without the prior approval required by the terms of the Medicare contracts.

- Executive car allowances of $7,576 were unsupported and other employees' mileage reimbursement costs exceeded amounts permitted under Federal Travel Regulations by $4,974.

- Travel costs for airfare included chartered planes for the corporate officers, usually the president/CEO, which exceeded the customary coach fare by $11,512.

- Travel costs for lodging exceeded the Federal Travel Regulations per diem lodging rates by $1,748.

AUDITEE COMMENTS

AIC concurred in $83,272 of our recommended financial adjustments (indirect costs - $76,550; employee mileage costs - $4,974; lodging costs - $1,748). AIC disagreed or did not respond to the remaining amounts questioned. In some instances, AIC provided additional information regarding items questioned in our draft report that were not available to us during our field work. This final report has reduced questioned amounts by $51,912 to reflect this additional information (deferred compensation - $51,700; automobile cost - $98; lodging cost - $114). AIC's written comments are summarized at the end of each finding and are attached as an Appendix to this report.

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INTRODUCTION

BACKGROUND

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

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

In 1996, AIC changed its corporate name to Anthem. Since AIC was the corporate name during our audit period, the report is addressed to AIC. From October 1, 1993 through September 30, 1995, AIC claimed $87,050,319 in administrative costs.

SCOPE

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

Our examination included audit procedures designed to achieve our objective and a review of accounting records and supporting documentation. The audit covered the period October 1, 1993 through September 30, 1995. Audit field work was performed at AIC's offices in Indianapolis, Indiana from October 1996 to April 1997.

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

FINDINGS AND RECOMMENDATIONS

COMPLEMENTARY CREDITS

The AIC understated complementary insurance credits causing the FACPs to be overstated by $934,382. Complementary insurer credits are the amounts received from insurance companies requesting AIC's Medicare claims processing data. The AIC's charges to complementary insurers included only cost centers directly involved in the complementary insurance process. The AIC excluded other cost centers from these cost allocations which benefitted claims processing activities, such as Medicare secondary payer (MSP), hearings and inquiries.

The Medicare Intermediary Manual (section 1601.c) states that the charges to the complementary insurers should include cost allocations from all cost centers that support the intermediaries claims processing activity, which include medicare secondary payer, and hearings and inquiries. HCFA program memorandum, AB-95-1, implemented in January 1995 which established fixed complementary rates, illustrates the application of section 1601 by stating that all claims processing activities should be included in the complementary insurer's cost allocation.

The AIC did not charge complementary insurers with cost centers such as MSP, hearings and inquiries, because AIC believes that these cost centers did not directly benefit the complementary insurer. The AIC believes that the January 1995 program memorandum was intended only as a guide and should not be applied retroactively.

Because AIC omitted several claims processing activities from the complementary insurance cost allocation and did not adhere to provisions in the Medicare manual, Medicare was overcharged by $934,382.

RECOMMENDATION

We recommend that AIC make a financial adjustment of $934,382, as follows:

	Part A	Part B	DMERC	Total
FY 1994:	$ 67,525	$195,495	$488,919	$751,939
FY 1995:	14,958	58,522	108,963	182,443
	$ 82,483	$254,017	$597,882	$934,382

Auditee Response

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

Auditors Comments

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

INDIRECT COST ALLOCATIONS

The AIC overstated costs by $525,762, because cost estimates were used and non-Medicare costs were charged to Medicare.

Estimated costs were allocated to Medicare without being adjusted to actual at yearend. As a result the FACPs were overstated by $449,212. AIC believed that the use of estimates was appropriate and did not require adjustment. The Medicare contracts state that the FACPs should contain only incurred costs, not estimates. We found that actual costs were approximately 33 percent lower than the estimated costs.

The AIC also overstated the FACPs by $76,550 because non-Medicare costs were allocated to Medicare. The non-Medicare costs included amounts applicable to acquisitions and mergers, reorganizations, and private company projects. The Medicare contracts state that all non-Medicare costs are unallowable.

RECOMMENDATIONS

We recommend that AIC:

1. Make a financial adjustment of $525,762, as follows:

	Part A	Part B	DMERC	Total
FY 1994:	$129,954	$184,691	$ 66,492	$381,137
FY 1995:	33,902	50,854	59,869	144,625
	$163,856	$235,545	$126,361	$525,762

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

Auditee Response

AIC agreed that costs were overstated by $76,550 because non-Medicare costs were allocated to Medicare.

AIC disagreed with five specific calculations we used in our recommendation to question the $449,212 attributable to use of estimates instead of actual costs. AIC states that using their calculations would eliminate our financial adjustment and give them a credit of $7,708.

Auditors Comments

We disagree with AIC's conclusions concerning the five calculations. Details follow.

Holding Company Expenses - AIC asserts that these expenses should not be included on the schedules which calculate the actual allocation percentages for the Holding Company.

This assertion is incorrect because the Holding Company does not allocate 100 per cent of its costs to its subsidiaries. The Holding Company must be included in the subsidiary's direct expenses to determine the allocation percentage of each component.

AdminaStar Information Technologies (AIT) Actual Expenses - AIC asserts that these expenses should be computed by subtracting AIT Fee for Service (FFS) Reimbursement from the total AIT Operating Expenses. The FFS amounts relate to private side data center functions picked up by AIT in a 1994 reorganization and passed-through to the private side users on a cost reimbursement basis.

This assertion is incorrect because FFS is included with the direct expenses. We included all direct expenses for all entities receiving allocations from the Holding company in our calculations. This methodology was previously acknowledged as correct by AIC.

Long-Term Incentive Charges For CEO - AIC asserts that these are allowable costs and we should have included them in our calculations.

This assertion is incorrect because long-term incentive charges are unallowable costs to the Medicare program. Refer to our discussion in the Deferred Compensation section (page 5).

Long-Term Incentive Charges For AdminaStar Employees - AIC asserts that these are allowable costs and we should have included them in our calculations.

This assertion is incorrect because long-term incentive charges are unallowable costs to the Medicare program. Refer to our discussion in the Deferred Compensation section (page 5).

FY 1995 Legal and Accounting Fees - AIC asserts that some of these expenses were not included in our calculations.

This assertion couldn't be substantiated with the documentation AIC provided to us.

DEFERRED COMPENSATION

The AIC overstated deferred compensation costs on the FACPs by $394,057, because $153,324 of the costs were unfunded, and $240,733 of the costs were for life insurance premiums unrestricted for use as deferred compensation.

The AIC's deferred compensation plan is a supplemental form of pension plan offered to its "highly compensated" employees. The plan supplements AIC's regular 401(k) plan. The AIC accrued deferred compensation costs of $153,324 based on estimates, without a corresponding cash set aside, and charged the costs to Medicare.

Federal regulations at 48 CFR 31.205-6(j)(i) state that pension costs must be funded before the filing date of the Federal income tax return. Pension costs assigned to the current year, but not funded by the deadline, are not allowable in a subsequent year.

AIC then paid $240,733 for life insurance on the deferred compensation plan participants to guarantee the deferred compensation plan in case of company bankruptcy. However, the AIC is the policy's beneficiary, and the policy benefits are not restricted for use as deferred compensation.

The AIC charged Medicare for both the life insurance premiums ($240,733) and the accrual accounting entries ($153,324). Both charges are unallowable since neither charge is for a cash contribution to a set aside fund.

RECOMMENDATION

We recommend that AIC make a financial adjustment of $394,057 as follows:

	Part A	Part B	DMERC	Total
FY 1994:	$ 65,371	$ 92,921	$ 33,453	$191,745
FY 1995:	46,666	71,808	83,838	202,312
	$112,037	$164,729	$117,291	$394,057

Auditee Response

AIC disagrees with our financial adjustment recommendation. In general, AIC has three areas of disagreement. First, AIC states that part of the Life Insurance portion of our finding should be reduced because the costs are attributable to the employee insurance program, not the deferred compensation program. AIC states adjusting for this would reduce our finding by $209,244.

Second, AIC states that their plan is a "non-qualified" deferred compensation plan that should be subject to deferred compensation regulations instead of pension regulations. AIC states that deferred compensation regulations at Sections 30.415 and 31-205-6 (k) of the Federal Acquisition Regulations (FAR) do not contain the same funding requirements that are applicable to pension plans. AIC states that one of the requirements for an unqualified deferred compensation plan is that it not be funded by cash contributions. AIC states that section 30.415-40 (b) of the FAR indicates that the amount of deferred compensation claimed shall be the present value of the future benefits to be paid.

Third, AIC states that there are two technical changes to our calculation of the Long Term Incentive (LTI) plan that would reduce our finding by $24,163 and $27,537 respectively.

Auditors Comments

AIC's assertions that part of the life insurance amount concerned the employee insurance program could not be verified with the information supplied by AIC.

AIC's assertion that these costs should not be subject to pension regulations is incorrect because these costs are part of a supplemental pension plan that allows the "highly compensated" executives to increase their retirement compensation. As such, AIC's plan meets the definition of a "non-qualified" defined benefit pension plan as described in 48 CFR 31.205-6(k)(3).

We agree with AIC's two technical changes to our calculation of the LTI plan and have accordingly reduced our finding by $24,163 and $27,537 respectively.

RETURN ON INVESTMENTS

The AIC overstated the FACPs by $203,689, because the return on investment costs were not calculated in accordance with the Medicare contracts. The net book value (NBV) of assets were inconsistently calculated each fiscal year, and the actual rate of return used by AIC was not in accordance with Medicare guidelines.

The AIC inconsistently calculated the NBV of investment assets, because different cost centers were included in the beginning and ending fiscal year NBVs to compute Return on Investments (ROI). Each year AIC allocates different cost centers to Medicare and does not match these cost center's beginning and ending NBVs. As a result, the beginning NBV figure was applicable to a different number of cost centers than used for the ending NBV figure. This difference caused AIC to either overclaim or underclaim allowable ROI in the years covered by this audit.

The AIC also did not compute the actual rate of return in accordance with Medicare guidelines. The Medicare contracts state that the ROI will be determined by multiplying the average undepreciated balance of investment assets by the actual rate of return of the contractor's investment portfolio for the contract period. The allowable investment assets include securities, savings accounts, mortgages, and other real or personal property held specifically for investment purposes. Unrealized capital gains are not considered part of the allowable investment assets, however, AIC included unrealized capital gains in their investment assets. Allowable investment income includes interest, dividends, rents, and realized capital gains and losses on the disposition of investments. AIC excluded realized capital gains from investment income to calculate the rate of return.

RECOMMENDATIONS

We recommend that AIC:

1. Make a financial adjustment of $203,689, as follows:

	Part A	Part B	DMERC	Total
FY 1994:	$ 21,322	$ 68,556	$ 23,479	$113,357
FY 1995:	16,004	52,191	22,137	90,332
	$ 37,326	$120,747	$ 45,616	$203,689

2. Follow Medicare guidelines to compute reasonable ROI costs claimed to Medicare.

Auditee Response

AIC disagrees with our financial adjustment recommendation. AIC states that the fixed asset values in our calculations appear to have excluded the costs for AdminaStar Print*Mail.

AIC also states that the "Yellow Book" Annual Statements that we used for our calculations only include part of AIC's invested assets and investment income. AIC states that amounts attributable to Anthem, Acordia, and other Subsidiaries are not covered in the "Yellow Book" and should be included for a "consolidated" AIC rate of return.

Auditors Comments

We did include the costs for Print*Mail in our Fiscal Year (FY) 1994 calculations. For FY 1995, AIC did not provide us with amounts attributable to Print*Mail.

The Medicare contract states that complete investment and income information should be contained on the annual statement made to the State Insurance Commissioner (i.e., the "Yellow Book" Annual Statement). AIC's response concerns figures contained on "Trial Balances" for the subsidiaries. We found that trial balance figures were frequently unreliable. And moreover, AIC's response does not adequately explain why annual statements presented to the State Insurance Commissioner would be incomplete and inaccurate.

POST-RETIREMENT HEALTH INSURANCE

The AIC overstated post-retirement health insurance costs on the FACPs by $187,404, because it did not fund its post-retirement plan in accordance with the Statement of Financial Accounting Standards (SFAS) No. 106 and applicable Federal regulations.

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

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

The AIC did not fund the post-retirement plan. These costs were based on accrual accounting entries, not cash contributions to an insurer, provider, or trustee.

RECOMMENDATION

We recommend that AIC make a financial adjustment of $187,404, as follows:

	Part A	Part B	DMERC	Total
FY 1994:	$ 18,297	$ 26,522	$ 9,549	$ 54,368
FY 1995:	31,186	46,778	55,072	133,036
	$ 49,483	$ 73,300	$ 64,621	$187,404

Auditee Response

AIC agreed that the post-retirement health benefit costs were not funded in accordance with SFAS 106. AIC states however that they have made several "pay as you go" payments and these payments should be substituted for the SFAS 106 accruals.

Auditors Comments

AIC has not provided us with documentation of their "pay as you go" payments.

EXECUTIVE SALARY INCREASES

The AIC overstated the FACPs by $182,337 for executive salary increases which exceeded the average increases for comparable positions as measured by the Department of Labor's Bureau of Labor Statistics (BLS) Employment Cost Index (ECI).

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

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

The average salary increases during the audit period on the ECI for executives in managerial/administrative areas were, as follows:

FY 1994 3.3% FY 1995 2.8%

The AIC's executive salary increases exceeded by $182,337 the average increases measured by the ECI.

RECOMMENDATION

We recommend that AIC make a financial adjustment of $182,337, as follows:

	Part A	Part B	DMERC	Total
FY 1994:	$ 43,639	$ 69,707	$ 33,866	$147,212
FY 1995:	8,081	12,486	14,558	35,125
	$ 51,720	$ 82,193	$ 48,424	$182,337

Auditee Response

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

AIC also suggested a technical correction for FY 1994 due to our analysis including an extra pay period, i.e., 27 pay periods instead of the usual 26 pay periods. AIC stated that their accrual for payroll would have included only 26 pay periods and we should exclude one pay period in our calculations.

Auditors Comments

Our analysis did consider changes within AIC's organization such as retirements, new-hires, and management incentive payments. Regarding changes in job responsibilities, our review included the six executives that AIC's response maintained had significant increases in responsibility. We found that these six executives had cumulative increases in their compensation package over the audit period averaging 21.6 percent. The related Bureau of Labor Statistics' cumulative increase was only 6.2 percent. These executives did have changes in job titles during the audit period, but while titles changed, the level of responsibility did not. These individuals were always essentially the CEO/VPs within their respective division and subsidiary company. Therefore we do not believe charging Medicare for compensation increases exceeding the BLS averages was justified.

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

Concerning AIC's comments about us using 27 pay periods for FY 1994, AIC's accrual for payroll for any year would include

26 pay periods plus one and sometimes 2 extra days (leap years) each year. Approximately every eight years an extra payroll(the 27th) is paid. Rather than count work days in each year and use exact decimals in calculating the finding, we simply used the number of paydays, which over an eight year period, evens out with the accrual. Our "executive salary increase" findings now span six years. We do not think it worthwhile to recalculate the findings for this and the previous audit which covered 1990 thru 1993.

PENSION COSTS

The AIC overstated the FACPs by $46,388 because its Supplemental Executive Retirement Plan (SERP) was not funded by cash contributions. The costs were based on accrual entries only. Regulations at 48 CFR 31.205-6(j)(2)(i) state that pension costs must be funded before an organization's Federal income tax return is due. Pension costs assigned to the current year, but not funded by the due date, are not allowable in a subsequent year.

RECOMMENDATIONS

We recommend that AIC:

1. Make a financial adjustment of $46,388, as follows:

	Part A	Part B	DMERC	Total
FY 1995:	$ 10,874	$ 16,311	$ 19,203	$ 46,388

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

Auditee Response

AIC did not agree with our financial recommendation. AIC states that these costs are a type of deferred compensation program that does not require yearly cash contributions.

Auditors Comments

The SERP costs should be considered a pension plan covered under the pension plan regulations, because employees can access these funds only upon retirement, disability, termination, or death.

INTEREST COSTS

The AIC claimed interest costs of $22,837 on the FY 1995 FACP. Regulations contained at 48 CFR 31.205-20, state that interest costs on borrowing, however represented, are unallowable.

RECOMMENDATION

We recommend that AIC make a financial adjustment of $22,837, as follows:

	Part A	Part B	DMERC	Total
FY 1995:	$ 5,353	$ 8,030	$ 9,454	$ 22,837

Auditee Response

AIC states that this interest expense is attributable to interest due to employees who have put some of their compensation into the Deferred Compensation Plan. AIC states that FAR section 30.415-50(d) does allow interest payments on deferred compensation.

Auditors Comments

AIC did not supply adequate information to verify their assertions about the nature of the interest expense.

PROFESSIONAL CONSULTANTS

The AIC overstated costs for professional consultant services by $19,401 due to unsupported retainer fees and excessive hourly rates.

The AIC charged Medicare with $15,206 of consultant retainer fees without evidence to support that services were provided. Federal regulations at 48 CFR 31.205-33(e) state that retainer fees must be supported by evidence of the nature and scope of the service furnished, details of all agreements, work requirements, rates, nature and amount of other expenses and details of actual services performed to be allowable.

The AIC paid $4,195 to several consultants at $150 to $400 per hour without the contracting officer's prior approval. The Medicare contract requires written approval by the contracting officer for consultant charges exceeding $400 per day.

RECOMMENDATIONS

We recommend that AIC:

1. Make a financial adjustment of $19,401, as follows:

	Part A	Part B	DMERC	Total
FY 1994:	$ 3,879	$ 5,557	$ 2,000	$ 11,436
FY 1995:	1,867	2,800	3,298	7,965
	$ 5,746	$ 8,357	$ 5,298	$ 19,401

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

Auditee Response

AIC disagrees with our financial adjustment. AIC states that $12,725 relates to retainer and other fees paid to members of the Board of Directors. AIC states that payments to the board members are allowable and not covered by FAR section 31.205-33(e).

AIC also states that contract provisions dealing with consulting fees in excess of $50 per hour are outdated now and should only serve to illustrate a need for approval of fees over a certain rate. AIC believes the intent of the contract provision is to require approval for major consulting operations directly applicable to Medicare and not for small consulting activities only partially applicable to Medicare.

Auditors Comments

The $12,725 represents fees paid to the board members in addition to the amounts paid to them for attending board meetings etc. AIC did not document what services or work was performed for the fees as required by federal regulations.

AIC's Medicare contract clearly states that AIC is to obtain the contracting officer's approval for rates in excess of $400 per day or $50 per hour.

AUTOMOBILE COSTS

The AIC overstated the FACPs by $12,550, representing unallowable executive car allowances and excessive mileage reimbursement for other employees. The Medicare contracts state that mileage costs charged to Medicare should not exceed that rate published in the Federal Travel Regulation (FTRs), as issued by the General Services Administration. In addition, the Medicare Intermediary Manual, appendix B, section 1156(G)(5) states that mileage should be business related and documented by the intermediary.

The AIC paid selected executives $7,576 representing a flat monthly fee ranging from $515 to $850 to reimburse the executives for the use of their personal automobiles. The AIC does not however require executives to maintain a mileage log for business miles.

The AIC used the Internal Revenue Service (IRS) mileage rate to reimburse other employees for business travel. The IRS mileage rate exceeded the mileage rate published by the FTR by $4,974.

RECOMMENDATIONS

We recommend that AIC:

1. Make a financial adjustment of $12,550, as follows:

	Part A	Part B	DMERC	Total
FY 1994:	$ 2,700	$ 5,382	$ 3,661	$ 11,743
FY 1995:	145	323	339	807
	$ 2,845	$ 5,705	$ 4,000	$ 12,550

2. Follow the Medicare guidelines to claim costs for mileage.

Auditee Response

AIC accepted our recommended financial adjustment concerning mileage reimbursement ($4,974).

AIC disagreed with the recommended financial adjustment of $7,576 concerning executive car allowances. AIC believes the car allowances are part of the executives' compensation packages and are not subject to business mileage record keeping requirements and travel rate limitations.

AIC also states that one car allowance payment of $98 included in the amount questioned in our draft report was not included in their Medicare reimbursements and should not be included in the questioned costs.

Auditors Comments

Regarding the $7,576 executive car allowances, the Federal regulations we cite provide for reimbursement of business mileage only.

We concur that $98 was inadvertently questionedin our draft report, and we have deleted the amount from costs questioned in this final report.

AIRFARE COSTS

The AIC claimed costs for chartered private jets used by the corporate officers, usually the President/CEO, which exceeded allowable coach airfares. Federal regulations at 48 CFR 31.205-46(d) state that airfare costs cannot exceed the lowest customary standard, coach, or equivalent airfare offered during normal business hours. The costs associated with the excessive airfare totaled $11,512.

RECOMMENDATION

We recommend that AIC:

1. Make a financial adjustment of $11,512, as follows:

	Part A	Part B	DMERC	Total
FY 1994:	$ 2,568	$ 3,655	$ 1,316	$ 7,539
FY 1995:	1,357	1,923	693	3,973
	$ 3,925	$ 5,578	$ 2,009	$ 11,512

Auditee Response

AIC states that our workpapers indicate that only 10 percent of the total airfare costs should be recommended for financial adjustment, but instead we recommended 90 percent of the costs for financial adjustment.

Auditors Comments

AIC misinterpreted our workpapers. Total airfare costs examined were $12,791. We stated that 10 percent of the total airfare costs ($1,279) should be allowed because that is the amount that approximates the allowable standard coach airfare. The $11,512 recommended for financial adjustment represents the amount that exceeds the allowable standard coach airfare.

LODGING COSTS

The AIC paid actual lodging costs instead of using the per diem rates set forth in the FTRs. Federal regulations at 48 CFR 31.205-46(a)(2) state lodging costs are reasonable only to the extent that they do not exceed on a daily basis the maximum per diem rates in effect at the time of travel in the FTRs. For 25 trips reviewed, lodging costs exceeded the FTRs per diem rates by $1,748.

RECOMMENDATIONS

We recommend that AIC:

1. Make a financial adjustment of $1,748, as follows:

	Part A	Part B	DMERC	Total
FY 1994:	$ 89	$ 214	$ 179	$ 482
FY 1995:	225	513	528	1,266
	$ 314	$ 727	$ 707	$ 1,748

2. Establish procedures to ensure that FTR per diem rates are used for lodging costs charged to Medicare.

Auditee Response

AIC accepted our recommended financial adjustment except for $114 concerning special circumstances for one trip.

Auditors Comments

We agree that $114 should not have been questioned, and we have deleted the amount from the costs questioned in this final report.

OTHER MATTERS

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

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

Auditee Response

The AIC requested that we include in this section mention of the fact that AIC, in an amended FACP dated October 23, 1996, increased its claimed DMERC expenses and that total expenses now exceed Notice of Budget Approval (NOBA) funding by $339,700.

Auditors Comments

We did not audit the additional costs claimed because costs exceeding the NOBA are not allowable for reimbursement. We did note, however, that documentation AIC provided to us did not readily support the additional costs.

EXHIBIT A

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART A)
AND THE OIG RECOMMENDATIONS
FOR THE FISCAL YEARS 1994 THROUGH 1995

Operation	Administrative Costs
Bills Payment	$7,266,666
Reconsideration and Hearings	462,740
Medicare Secondary Payer	1,233,929
Medicare and Utilization Review	1,077,871
Provider Desk Reviews	1,999,999
Provider Field Audits	2,063,651
Provider Settlements	895,079
Provider Reimbursements	1,227,168
Productivity Investments	94,900
Benefit Integrity	189,346
Other	175,935
Complementary Insurance Credits	(288,616)
Total Administrative Costs Claimed	$16,398,668
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 82,483
2. Indirect Cost Allocations	163,856
3. Deferred Compensation	112,037
4. Return on Investments	37,326
5. Post-Retirement Health Insurance	49,483
6. Executive Salary Increases	51,720
7. Pension	10,874
8. Interest	5,353
9. Professional Consultants	5,746
10. Automobile	2,845
11. Airfare	3,925
12. Lodging	314
Total Adjustments	$ 525,962
Costs Recommended For Acceptance	$15,872,706

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

EXHIBIT B

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)
AND THE OIG RECOMMENDATIONS
FOR THE FISCAL YEARS 1994 THROUGH 1995

Operation	Administrative Costs
Claims Payment	$23,674,343
Reviews and Hearings	3,321,386
Beneficiary/Physician Inquiry	4,303,574
Professional Education and Training	812,092
Medical and Utilization Review	2,919,834
Medicare Secondary Payer	1,441,607
Participating Physician	545,309
Productivity Investments	224,175
Complementary Insurance Credits	(2,106,432)
Benefit Integrity	1,148,875
Other	648,622
Total Administrative Cost Claimed	$36,933,385
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 254,017
2. Indirect Cost Allocation	235,545
3. Deferred Compensation	164,729
4. Return on Investments	120,747
5. Post-Retirement Health Insurance	73,300
6. Executive Salary Increases	82,193
7. Pension	16,311
8. Interest	8,030
9. Professional Consultants	8,357
10. Automobile	5,705
11. Airfare	5,578
12. Lodging	727
Total Adjustments	$ 975,239
Costs Recommended For Acceptance	$35,958,146

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

EXHIBIT C

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (DMERC)
AND THE OIG RECOMMENDATIONS
FOR THE FISCAL YEARS 1994 THROUGH 1995

Operation	Administrative Costs
Claims Payment	$19,362,073
Reviews and Hearings	3,157,166
Beneficiary/Physician Inquiry	4,584,446
Provider Education and Training	2,297,813
Medical and Utilization Review	2,849,683
Medicare Secondary Payer	698,838
Participating Physician	188,024
Productivity Investments	165,031
Benefit Integrity	1,612,379
Complementary Insurance Credits	(1,197,187)
Total Administrative Costs Claimed	$33,718,266
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 597,882
2. Indirect Cost Allocation	126,361
3. Deferred Compensation	117,291
4. Return on Investments	45,616
5. Post-Retirement Health Insurance	64,621
6. Executive Salary Increases	48,424
7. Pension	19,203
8. Interest	9,454
9. Professional Consultants	5,298
10. Automobile	4,000
11. Airfare	2,009
12. Lodging	707
Total Adjustments	$ 1,040,866
Costs Recommended For Acceptance	$32,677,400

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

EXHIBIT D

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COSTS PROPOSAL (PART A)
AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1993 THROUGH SEPTEMBER 30, 1994

Operation	Administrative Costs
Bills Payment	$3,382,294
Reconsideration and Hearings	250,352
Medicare Secondary Payer	695,824
Medical and Utilization Review	431,841
Provider Desk Reviews	1,141,309
Provider Field Audits	929,295
Provider Settlements	401,861
Provider Reimbursements	622,160
Productivity Investments	39,514
Benefit Integrity	70,394
Total Administrative Costs Claim	$7,964,844
Recommended Adjustments:	
1. Indirect Cost Allocation System	$ 129,954
2. Deferred Compensation	65,371
3. Complementary Insurance Credits	67,525
4. Executive Salary Increases	43,639
5. Return on Investments	21,322
6. Post-Retirement Health Insurance	18,297
7. Professional Consultants	3,879
8. Automobile	2,700
9. Airfare	2,568
10. Lodging	89
Total Adjustments	$ 355,344
Costs Recommended For Acceptance	$7,609,500

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

EXHIBIT E

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)
AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1993 THROUGH SEPTEMBER 30, 1994

Operation	Administrative Costs
Claims Payment	$10,706,240
Reviews and Hearings	1,699,828
Beneficiary/Physician Inquiry	2,188,543
Provider Education and Training	445,896
Medical and Utilization Review	[illegible],500,946
Medicare Secondary Payer	654,213
Participating Physician	313,661
Productivity Investments	190,963
Benefit Integrity	546,444
Other	82,339
Total Administrative Costs Claimed	$18,329,073
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 195,495
2. Indirect Cost Allocation System	184,691
3. Deferred Compensation	92,921
4. Executive Salary Increases	69,707
5. Return on Investments	68,556
6. Post-Retirement Health Insurance	26,522
7. Professional Consultants	5,557
8. Automobile	5,382
9. Airfare	3,655
10. Lodging	214
Total Adjustments	$ 652,700
Costs Recommended for Acceptance	$17,676,373

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

EXHIBIT F

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (DMERC)
AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1993 THROUGH SEPTEMBER 30, 1994

Operation	Administrative Costs
Claims Payment	$7,904,415
Reviews and Hearings	1,162,962
Beneficiary/Physician Inquiry	2,052,369
Provider Education and Training	1,032,384
Medical and Utilization Review	1,326,699
Medicare Secondary Payer	365,612
Participating Physician	132,076
Productivity Investments	63,827
Benefit Integrity	649,216
Total Administrative Costs Claimed	$14,689,560

Recommended Adjustments:

1. Complementary Insurance Credits	$ 488,919
2. Indirect Cost Allocation System	66,492
3. Deferred Compensation	33,453
4. Executive Salary Increases	33,866
5. Return on Investments	23,479
6. Post-Retirement Health Insurance	9,549
7. Automobile	3,661
8. Professional Consultants	2,000
9. Airfare	1,316
10. Lodging	179
Total Adjustments	$ 662,914
Costs Recommended For Acceptance	$14,026,646

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

EXHIBIT G

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART A)
AND OIG RECOMMENDATIONS
OCTOBER 1, 1994 THROUGH SEPTEMBER 30, 1995

Operation	Administrative Costs
Bills Payment	$3,884,372
Reconsideration and Hearings	212,388
Medicare Secondary Payer	538,105
Medical and Utilization Review	646,030
Provider Desk Reviews	858,690
Provider Field Audits	1,134,356
Provider Settlements	493,218
Provider Reimbursements	605,008
Productivity Investments	55,386
Benefit Integrity	118,952
Other	175,935
Complementary Insurance Credits	(288,616)
Total Administrative Costs Claimed	$8,433,824
Recommended Adjustments:	
1. Deferred Compensation	$ 46,666
2. Indirect Cost Allocation System	33,902
3. Post-Retirement Health Insurance	31,186
4. Return on Investments	16,004
5. Complementary Insurance Credits	14,958
6. Pension	10,874
7. Executive Salary Increases	8,081
7. Interest	5,353
9. Professional Consultants	1,867
10. Airfare	1,357
11. Lodging	225
12. Automobile	145
Total Adjustments	$ 170,618
Costs Recommended For Acceptance	$8,263,206

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

EXHIBIT H

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)
AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1994 THROUGH SEPTEMBER 30, 1995

Operation	Administrative Costs
Claims Payment	$12,968,103
Reviews and Hearings	1,621,558
Beneficiary/Physician Inquiry	2,115,031
Provider Education and Training	366,196
medical and Utilization Review	1,418,888
Medicare Secondary Payer	787,394
Participating Physician	231,648
Productivity Investments	33,212
Benefit Integrity	602,431
Complementary Insurance Credits	(2,106,432)
Other	566,283
Total Administrative Costs Claimed	$18,604,312
Recommended Adjustments:	
1. Deferred Compensation	$ 71,808
2. Complementary Insurance Credits	58,522
3. Return on Investments	52,191
4. Indirect Cost Allocation System	50,854
5. Post-Retirement Health Insurance	46,778
6. Pension	16,311
7. Executive Salary Increases	12,486
8. Interest	8,030
9. Professional Consultants	2,800
10. Airfare	1,923
11. Lodging	513
12. Automobile	323
Total Adjustments	$ 322,539
Costs Recommended For Acceptance	$18,281,773

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

EXHIBIT I

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (DMERC)
AND OIG RECOMMENDATIONS
OCTOBER 1, 1994 THROUGH SEPTEMBER 30, 1995

Operation	Administrative Costs
Claims Payment	$11,457,658
Reviews and Hearings	1,994,204
Beneficiary/Physician Inquiry	2,532,077
Provider Education and Training	1,265,429
Medical and Utilization Review	1,522,984
Medicare Secondary Payer	333,226
Participating Physician	55,948
Productivity Investments	101,204
Benefit Integrity	963,163
Complementary Insurance Credits	(1,197,187)
Total Administrative Costs Claimed	$19,028,706

Recommended Adjustments:

1. Complementary Insurance Credits	$ 108,963
2. Deferred Compensation	83,838
3. Indirect Cost Allocation System	59,869
4. Post-Retirement Health Insurance	55,072
5. Return on Investments	22,137
6. Pension	19,203
7. Executive Salary Increases	14,558
8. Interest	9,454
9. Professional Consultants	3,298
10. Airfare	693
11. Lodging	528
12. Automobile	339
Total Adjustments	$ 377,952
Costs Recommended For Acceptance	$18,650,754

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

APPENDIX

AdminaStar Federal Medicare

Provider Audit & Reimbursement

September 29, 1997

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

RE: Draft Audit Report
FY 1994-1995 Medicare FACP's

Dear Mr. Pound:

In response to the letter from Paul Swanson dated July 30, 1997, we have prepared the attached responses to the adjustments included in your draft audit report for Fiscal Years 1994-1995.

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

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

If you have questions or need additional information, please contact Dennis Brinker or myself.

Sincerely,

Robert B. Fleming

Robert Fleming
Vice President and Chief Financial Officer

RF/DB:pml

cc: S. Crickmore
P. Rusterholz
B. Toller

Complementary Insurance Credits

After review of the draft audit adjustment and supporting workpapers, we remain convinced that our original complementary insurance credit rates used in the preparation of the FY 1994-1995 FACP's are reasonably computed in accordance with Section 1601 of the Medicare Intermediary Manual. This manual section had been in place since the original effective date of May 16, 1986 without any modification or clarification by HCFA. Since 1986, HCFA has not performed an audit of the complementary coverage methodology or questioned the actual rates used in any fashion. On the FY 1987-1989 FACP audit, another method was used but those adjustments were not proposed until well into FY 1993. We do strongly disagree with the proposed 1987-1989 adjustments for the same reasons we present in this response.

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

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

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

1. Medicare Secondary Payor

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

2. Recons and Hearings

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

3. Inquiries

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

4. Medical Review Costs

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

5. Other Costs

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

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

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

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

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

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

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

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

6. We question whether Part B complementary claims transfers to external companies (other than AICI) should be included in the adjustment calculation. Contracts negotiated with external companies set the rate to be charged per claim. Since the contract controls rates of payment, all monies received were offset against expenses on the FACP, and there is no mechanism for collecting more, rates should be considered final without adjustment. In FY 1994 and 1995 after the initiation of the DMERC program, external claim transfers for both Part B and DMERC increased significantly. Over 90% of the DMERC transfers are external.

7. DMERC Program

Assumption of the DMERC contract and separate reporting of DMERC expenses to HCFA were initiated in FY 1994. During FY 1994 and early FY 1995 (the period which the Complementary Insurance Credits adjustment covers) the DMERC contract was in a start-up phase. Claims workload was slowly transferred from other carriers to AICI; the scheduled transition was delayed several times due to implementation problems all the DMERC's were encountering. Since our DMERC staff was in place as required, the reduced workload flow during FY 1994 resulted in a significantly higher cost per claim processed.

The Complementary Insurance Credit adjustment for DMERC of $597,882 is 64% of the total adjustment. The DMERC adjustment for FY 1994, the specific start-up period, is over 52% of the total adjustment. We used a consistent approach with Part A and Part B to develop the crossover rate for DMERC and did calculate a higher DMERC rate due to higher cost estimates for that program. The rate we developed and charged did not anticipate the increased costs due to transition problems and delays.

In our opinion, it would have been inappropriate to charge complementary insurance providers higher rates per crossover claim because of the transition problems all DMERC's encountered in the implementation. Though we maintain that the entire Complementary Insurance Credit adjustment is inappropriate, we suggest that, at a minimum, the DMERC adjustment be reduced by using the calculated Part B rates for FY 1994 and 1995 instead of the transition affected DMERC rates. In a way, HCFA supported this concept by requiring that we also use the Part B rates for DMERC after the move to fixed complementary insurance rates at January 1, 1995.

In summary, the complementary credit rates used in these fiscal years are based on actual costs and are reasonable in relation to existing manual instructions at the time. A good faith effort to follow the limited instructions available should not be retroactively adjusted based upon a 1995 instruction that only supports a fixed rate for the future. At a minimum, the DMERC adjustment should be reworked to eliminate the effect of the higher phase-in costs that should not reasonably be charged to complementary insurers.

Indirect Cost Allocation System

Our response to the two areas covered in this adjustment is as follows:

1. Allocation of Non-Medicare Costs

   This adjustment which totals $76,550 involves specific corporate office expense items considered to be unrelated to Medicare. These individual items were included in corporate office cost centers that were otherwise appropriately allocated to our Medicare contracts. After review of the audit workpapers, we accept this adjustment.

2. AdminaStar, Inc. Holding Company Allocations to Medicare

   AdminaStar, Inc. provides management and other administrative services to our Medicare operations. AdminaStar, Inc. expenses are partially allocated to our Medicare contracts on a monthly basis using accumulated costs of the subsidiaries managed by AdminaStar, Inc.

   We agree with the auditors' finding that budgeted rather than actual expenses was used to determine the allocation percentage for FY 1994-1995. We do believe, however, that the percentages being used were reasonable in comparison to actual expense based calculations.

   We have reviewed the actual cost allocation methodology developed by the auditors and have identified the following necessary changes:

   a) Holding Company expenses should not be included on the schedules which calculate the "Actual Allocation Percentages for the Holding Company". Exclusion of Holding Company expenses from the allocation basis properly allocates the expenses to the subsidiary companies it owns and operates.

   b) As documented on the attached AdminaStar Income Statements, the AdminaStar Information Technologies (AIT) actual expenses should be $10,769,500 for the nine months ended September 30, 1994 and $2,584,200 for the three months ended December 31, 1994. These amounts were computed by subtracting AIT Fee for Service (FFS) Reimbursement from the total AIT Operating Expenses. The FFS amounts relate to private side data center functions picked up by AIT in a 1994 reorganization and passed-through to the private side users on a cost reimbursement basis. AIT is a division of AdminaStar, Inc., not a subsidiary and almost all of its data processing and other services are provided internally to other AdminaStar and AICI companies. Since AIT is primarily a support unit to other external revenue producing subsidiaries, a logical argument can be made for excluding AIT expenses from the allocation basis entirely. If allocations of holding company expenses are to be made to AIT, then the appropriate share of those allocated expenses should be carried forward to users of AIT's services. Of course, the Medicare operations within AdminaStar Federal are the largest user of AIT services.

Currently, we have used the conservative allocation approach of including AIT direct expenses in the basis and not secondarily allocating AIT related Holding Company costs back to Medicare contracts. This approach no longer appears appropriate if the private data center pass through expenses added to AIT in 1994 are included in the allocation basis.

c) Long term incentive charges applicable to the AdminaStar subsidiary CEO's were backed out of holding company expenses to be allocated. The incentive specifically applicable to * was then added each month to the AdminaStar allocation to AdminaStar Federal. Review of the audit workpapers indicates that these charges were excluded from the calculation thus increasing the proposed audit adjustment. Amounts involved are $45,511 for FY 1994 and $25,584 for FY 1995. Attached are copies of original allocation schedules which document the monthly incentive charge for * .

d) The original Long Term Incentive charge for AdminaStar, Inc. employees was excluded from the November, 1993 allocation calculation, but was added back in December after receipt of additional information. This amount ($325,000) was not included in the audited allocation. Attached is the December, 1993 allocation schedule which documents the add-back.

e) Necessary gross-ups to expenses to add-back legal and accounting fees for a portion of FY 1995 were not included in the audit calculation. These items were credits but not in the 840025 account picked up by the auditors. We made monthly prescribed charges to other AdminaStar companies and needed to add them back to get total expenses for Medicare allocation purposes.

In summary, we have attached schedules which recompute both the percentages of expenses allocable to AdminaStar Federal and the allocation amounts incorporating the revised percentages and other revisions noted above. We believe these schedules should be the basis of revised adjustments.

* NAME DELETED

	FY 1994	FY 1995
Co. 2010 Actual Expense (Audit W/P)	$1,692,159	$1,706,541
Add: Holding Co. Long Term Incentive	325,000	-0-
Gross Up Legal and Accounting Expenses	-0-	101,625
Revised Expenses	2,017,159	1,808,166
Allocation % (Recalculated)	32.93%	29.66%
Revised Allocation	$664,250	$536,302
Add: Direct ASF Long Term Incentive	45,511	25,584
Total Revised Allocation	709,761	561,886
Original Allocation - ASF	(709,623)	(569,732)
Restated Adjustment	$138	$(7,846)

INDIRECT COST ALLOCATION

Calculate the Total Direct Expenses for AdminaStar, Inc.								
Qtr. End.	AIT	HC	Federal	Kentucky	Solutions	Defense	Print Mail	Total
Dec-93								
Total	4.1		10.0	0.0	1.4	4.6	3.3	23.4
Alloc.			(0.3)					(0.3)
	4.1	0.0	9.7	0.0	1.4	4.6	3.3	23.1
Sep-94								
Total	10.8		31.2	17.5	5.0	21.9	13.9	100.3
Alloc.			(0.4)					(0.4)
	10.8	0.0	30.8	17.5	5.0	21.9	13.9	99.9
FY 94	14.9	0.0	40.5	17.5	6.4	26.5	17.2	123.0
FY 94 %	12.11%	0.00%	32.93%	14.23%	5.20%	21.54%	13.98%	100.00%
Dec-94								
Total	2.5		11.3	5.1	1.7	9.8	7.7	38.1
Alloc.			(0.2)					(0.2)
	2.5	0.0	11.1	5.1	1.7	9.8	7.7	37.9
Sep-95								
Total	30.4		34.2	17.0	3.1	29.2	0.0	113.9
Alloc.			(0.4)					(0.4)
	30.4	0.0	33.8	17.0	3.1	29.2	0.0	113.5
FY 94	32.9	0.0	44.9	22.1	4.8	39.0	7.7	151.4
FY 94 %	21.73%	0.00%	29.66%	14.60%	3.17%	25.76%	5.09%	100.00%

Deferred Compensation

In total, the adjustment to eliminate claimed Deferred Compensation expense includes the following types of expenses:

1. Life Insurance
2. Deferred Company Match
3. Long-Term Incentive Plan

Our comments regarding each expense component are as follows:

1. Life insurance

   Our research indicates that the expenses accumulated in this category relate to monthly "House Account" entries made to the Employee Life Insurance account (805020) in the Employee Benefits Cost Center (0112).

   Attached are copies of the detail supporting the "House Account" entry for several months during the period under audit. The detail and the cost center of inclusion indicate that the expenses involved relate to the employee insurance program and not the deferred compensation program. Insurance premiums applicable to policies purchased as part of the deferred compensation program are included in Cost Center 0111, Executive Benefits.

   In summary, the Employee Life Insurance segment of this adjustment should be eliminated, reducing the FY 1994 adjustment by $87,128 and the FY 1995 adjustment by $122,116.

2. Deferred Company Match and Remainder of Life Insurance Adjustment

   The rest of the Life Insurance adjustment does relate to the insurance purchased as security for the company and participants in the Deferred Compensation program. The company match expenses relate primarily to the accruals for matching payments to participants who defer salaries up to 6% that cannot by law be put in the company 401k plan.

   We agree that these amounts are not funded since funding is not allowed on an unqualified plan. Our review of applicable regulations indicates that a Pension Plan is one form of a deferred compensation plan. Pension plans have detailed regulations covering accounting and cost allocability that, in our opinion, do not necessarily apply to other types of Deferred Compensation plans. Sections 30.415 and 31-205-6(k) of the Federal Acquisition Regulations cover accounting for deferred compensation plans. These sections do not contain the funding requirements applicable to pension plans. Section 30.415-20(b) reads that "This standard is applicable to the cost of all deferred compensation except for compensated personal absences and pension plan costs which are covered in other Cost Accounting Standards".

In general, expenses recorded and interest accrued into deferred compensation are liabilities of the corporation at the time they are recorded. If a plan participant leaves the company at any time, the company is liable for all deferrals and accumulated interest. Section 30.415-40(b) does indicate that the amount of deferred compensation claimed shall be the present value of the future benefits to be paid.

Based upon this analysis and supporting regulations, we believe that the deferred compensation expenses questioned here are allowable.

3. Long-Term Incentive Plan

Expenses charged here relate to a Long Term Incentive Plan established for key executives early in FY 1994. It was designed to provide recognition for the achievement of specific goals with graduated vesting as executives remain with the corporation. Expenses were accrued for the incentive awards made in FY 1994 and FY 1995 though vesting did not occur during that period.

As noted in the finding, expenses accrued for this plan are not funded. On the other hand, FAR regulations referenced above do not appear to require funding for certain types of deferred compensation to be allowable.

Regardless of the resolution of the information provided above, we request two technical changes to the calculation of the Long Term Incentive (LTI) plan adjustment as follows:

A. Your audit workpapers accumulating the FY 1994 LTI accruals correctly took into account adjustments (exception allocations) we put into place to determine the proper allocations to our Medicare contracts. On the other hand, your workpaper for FY 1995 which accumulates accruals from October to December, 1994 does not back out comparable adjustments (exception allocations) made for these months. Attached are supporting documents which demonstrate $160,000 per month adjustments for the three months. Application of these adjustments would eliminate that portion of your FY 1995 Deferred Compensation adjustment which now totals $24,163.

B. Your adjustment picks up Long Term Incentive accruals charged to Medicare through the AdminaStar Holding Company. In another adjustment, you reduced the percentage of holding company expenses charged to Medicare. If the holding company allocation adjustment stands, the revised percentages should be used to calculate this adjustment. This change reduces the FY1994 adjustment by $20,[illegible]51 and the FY 1995 adjustment by $6,586.

Return on Investment (ROI)

We have reviewed the workpaper support for this finding which modifies both the Asset Values and the rate of return we used in developing the ROI amounts included on the FY 1994-1995 FACP's. The following comments address each item individually.

1. Fixed Asset Values

   a) AdminaStar Print*Mail - It appears that net book value information related to this entity was excluded from the audit calculation. Print*Mail provided printing, mailing, and certain record storage services for our Medicare contracts and thus has, since it was established, been a part of the ROI calculation.

      Attached is a summary schedule for each fiscal year which includes calculated Medicare specific asset net book values for AP*M. Also included is supporting information received from AP*M which documents total asset values and the allocation basis used to determine the Medicare share. Even at the audited rate of return, inclusion of this data increases the total Medicare ROI by $21,517 in FY 1994 and by $24,540 in FY 1995.

   b) Allocation percentages used for the AdminaStar, Inc. Holding Company should be changed for this calculation to the extent the holding company allocation is modified.

2. Rate of Return

   We have reviewed the "Yellow Book" Annual Statements for AICI that were used to develop the audited rates of return and compared them to the corporate data provided to us by the corporate office investment staff and used for our original computations. In this review, we noted that the Yellow Book information only included "Mutual" invested assets and investment income and not Anthem, Acordia, or other subsidiary data which must be added to obtain consolidated AICI totals. We believe it is reasonable and acceptable to include all AICI invested funds in determining a Rate of Return.

   Attached are 1993 schedules which document that AICI subsidiaries are included in the source data we used and that subsidiaries are excluded from the Yellow Book presentation. One set of the schedules is for September, 1993 rather than December, but it still can be used to demonstrate the reconciliation. For example, the audit calculation includes $1,000,000 of Preferred Stock at December 31, 1993. The attached consolidated schedule includes Preferred Stock as follows as of September 30, 1993:

	Pref. Stock Banks/Trust	Pref. Stock Other	Total
Mutual		$1,000,000	$1,000,000
Acordia Holding	$1,020,000		$1,020,000
Anthem life Ins.	513,530	1,230,000	1,743,530
Anthem Insurance		1,652,400	1,652,400
Total	$1,533,530	$3,882,400	$5,415,930

By December, 1993, the balances only changed slightly. We are obtaining and can provide comparable Consolidated Trial Balance schedules for 1994 and 1995 which can be used to reconcile our corporate rate of return calculation to the Yellow Book information used at audit.

The attached ROI calculation summaries demonstrate that we did exclude unrealized gains from total Invested Assets used for the calculation. After further review, we agree that capital gains were excluded from Investment Income for our calculation. We have checked Consolidated AICI Trial Balances for 1993, 1994 and 1995 and noted that significant gains were made in each year. Including these gains for all AICI components would only have increased our computed ROI.

In summary, we believe a consolidated AICI rate of return calculation is appropriate and that the rates used in the original FACP filings are, if anything, understated. If you have questions or need additional documentation, just let us know.

Post Retirement Health Insurance

We agree that FASB 106 expense accruals for Post Retirement Health insurance in the FACP were not funded by AICI as is required for Medicare allowability. AICI chose to continue the "pay as you go" approach to Post Retirement Health Benefits and made a substantial amount of health claim payments out of general operating funds. Prior to the FASB change, these payments were recorded as expense; in 1993 and after, they were treated as offsets against the FASB liability set up with the expense accruals.

We propose that actual payments made for retiree health claims be allowed as a substitute for the FASB 106 accruals. In our opinion, the allocation of actual payments to Medicare should be the same percentages used to originally allocate the FASB 106 accruals. Development of actual retiree headcount Medicare percentages is unrealistic due to the large number of AICI retirees before AdminaStar was ever formed. A significant number of the AICI retirees worked directly in Medicare operations and many others worked in areas that had some allocation to Medicare.

We are still working to accumulate appropriate documentation to support actual retiree health payments made by the corporation in FY 1994 and 1995. We will forward that information to you as soon as it is complete.

Executive Salary Increases

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

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

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

1. This adjustment carries forward the methodology used in the previous FACP audit covering Fiscal Years 1990-1993. Thus the original selection of FY 1989 as the base year for the allowability computation remains in effect. As noted in our previous response, 1989 was a period of massive change for AICI. Many of the changes which led to a dramatic increase in the size of the company were just being planned or initiated in 1989. For these reasons we question the selection of 1989 as an appropriate base year.

2. With the total corporate reorganization and expansion during the base year and audit period, corporate office staff Medicare allocation percentages were actually being reduced. Reductions are particularly evident in the later years under audit. In effect, the actual allocation of cost to Medicare did not increase in proportion to the increase in compensation. These reductions continued in FY 1994-1995.

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

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

5. More specific examples of organizational changes affecting the selection of 1989 as a reasonable base year and your test of the reasonableness of executive compensation are detailed as follows:

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

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

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

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

* NAME DELETED

One technical item should be considered for modification if the adjustment remains as reflected in the draft report. The FY 1994 calculation for all the executives involved reflects 27 pay periods. Apparently this was caused by October 1, 1993 itself being a pay date. The company's accrual system would have limited total expense for the period to 26 pay periods. We also noted that the Executive Compensation computation for the preceeding year does include 26 pay periods. For these reasons, we propose that the FY 1994 calculations be revised to exclude one pay period for each executive.

In summary, we propose that the entire adjustment to Executive Salary Increases be eliminated due to lack of specific regulation support and the information presented regarding organizational and position changes occurring at AICI during the base year and audit periods. If the adjustment stands for the final report, we request consideration of the technical correction suggested.

Pension Costs

The entire adjustment for FY 1995 relates to expenses charged for the Supplemental Executive Retirement Plan (SERP) established for the most highly compensated employees whose participation in the employee pension plan was limited due to their level of compensation.

We agree that expenses charged under this program are not funded by AICI as is required for pension cost allowability. We question, however, whether the funding requirement applies to this type of deferred compensation program. See our response to the Deferred Compensation finding for additional information.

Interest Costs

Our review of journal entries indicates that the Interest Expense included in this account relates to calculated interest due to employees who have put some of their compensation into the Deferred Compensation Plan. The interest included here does not represent interest costs on any borrowing as indicated in the finding.

FAR Section 30.415-50(d) does indicate that interest is an allowable component of deferred compensation costs. The deferred compensation balances upon which the interest is being calculated are compensation awards that management employees have chosen to defer into the non-qualified plan established by the corporation.

Professional Consultants

The expenses analyzed and disallowed as a part of this adjustment were incurred by the corporate office and included in cost centers which have small percentages of their expenses allocated to Medicare.

We agree with this adjustment with two exceptions. First, of the $15,206 Retainer Fees adjustment, $12,725 ($8,394 in FY 1994 and $4,331 in FY 1995) relates to retainers and other fees paid to members of the AICI Board of Directors. We believe that payments to members of the Board of Directors are allowable and not covered by FAR Section 31.205-33(e) as identified in the finding.

Secondly, we believe that the portion of the adjustment related to consulting fees in excess of $50 per hour should be reversed. We agree that an extremely old contract provision indicates a need for approval of fees over a certain level. We believe, however, that the intent was to require approval for major consulting operations directly applicable to Medicare and not for small consulting activities only partially applicable to Medicare.

Automobile Costs

This adjustment involves two types of Automobile related costs:

1. Mileage rates paid to employee for business travel in their personal car.
2. Monthly car allowances paid to corporate executives.

We accept the mileage rate adjustment. Our rate per mile did exceed the Federal Travel Rate limit until January 1, 1995. We had made an incorrect assumption that the rate would be retroactively increased in line with the approved IRS rate.

The car allowance program during its existence was considered to be part of an executive's total compensation package. Inclusion of these payments on the employee earnings history support the compensation classification. We believe that this expense should not be subject to business mile recordkeeping requirements and should thus be allowed. On a more technical note, Cost Center 3700 payments are included in this adjustment even though this cost center's expenses were excluded from the FACP. Correction will reduce the adjustment by $98.

Airfare Travel Costs

Audit workpapers R-5 supporting this adjustment appear to indicate that 10% of the total cost in question should be excluded as exceeding standard coach rates. The actual adjustment eliminated 90% of those costs. We suggest that the adjustment be modified to the following:

	Medicare Questionned	10% Backout
1994		
A	$2,853	$285
B	4,061	406
DMERC	1,462	146
Total	$8,376	$837
1995		
A	$1,508	$151
B	2,137	214
DMERC	770	77
Total	$4,415	$442
GRAND TOTAL	$12,791	$1,279

Lodging Travel Costs

We accept this adjustment with one requested modification. The attached expense voucher copy for a * trip paid on October 17, 1994 indicates that *, another Provider Audit employee, stayed in the same room as *. The payment for double occupancy caused the room rate to exceed the Federal Travel Rate limit. Modification of the finding to eliminate this item will reduce the FY 1995 finding by $114.

* NAME DELETED

Other Matters

Through an amended FACP dated October 23, 1996, we increased reported DMERC expenses to $19,028,706, an amount $339,700 higher than available Notice of Budget Approval (NOBA) funding. Since expenses exceeded the NOBA, we have not been able to draw funds from HCFA to cover these expenses.

We believe this information should be identified in the Audit Report to set the stage for HCFA reimbursement of this additional expense through the final settlement process.