



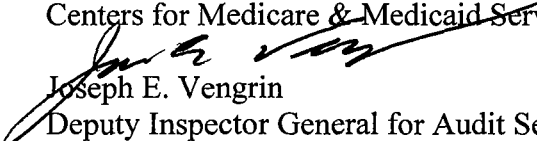
DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

SEP 14 2006

**TO:** Mark B. McClellan, M.D., Ph.D.  
Administrator  
Centers for Medicare & Medicaid Services

**FROM:**   
Joseph E. Vengrin  
Deputy Inspector General for Audit Services

**SUBJECT:** Review of University of California, San Diego Medical Center's Reported Fiscal Year 2004 Wage Data (A-09-06-00027)

Attached is an advance copy of our final report on University of California, San Diego Medical Center's (the Medical Center's) reported fiscal year (FY) 2004 wage data. We will issue this report to the Medical Center within 5 business days.

This review is one in a series of reviews of the accuracy of hospitals' FY 2003 wage data, which the Centers for Medicare & Medicaid Services (CMS) will use in developing FY 2007 wage indexes. Because the Medical Center's FY 2004 began during Federal FY 2003, CMS will use the FY 2004 Medicare cost report to develop the FY 2007 wage index.

Under the prospective payment system for acute care hospitals, Medicare Part A pays hospitals at predetermined, diagnosis-related rates for patient discharges. The payment system base rate includes a labor-related share. CMS adjusts the labor-related share by the wage index applicable to the area in which a hospital is located.

The objective of our review was to determine whether the Medical Center complied with Medicare requirements for reporting wage data for pension and postretirement benefit costs in its FY 2004 Medicare cost report.

The Medical Center did not fully comply with Medicare requirements for reporting wage data for pension and postretirement benefit costs in its FY 2004 Medicare cost report. Specifically, the Medical Center overstated its wages by \$47,773,319. Our correction of the Medical Center's errors reduced the average hourly wage rate approximately 19 percent from \$41.74 to \$33.75. The errors in reported wage data occurred because the Medical Center did not sufficiently review and reconcile wage data to ensure that pension and postretirement benefit amounts reported were accurate, supportable, and in compliance with Medicare regulations and guidance.

If the Medical Center does not revise the wage data in its FY 2004 cost report, the applicable FY 2007 core-based statistical area wage index will be overstated, which will result in overpayments to the Medical Center and the other hospitals that use this wage index.

We recommend that the Medical Center:

- submit a revised FY 2004 Medicare cost report to the fiscal intermediary to correct the overstated pension and postretirement benefit wage data totaling \$47,773,319 and
- implement review and reconciliation procedures to ensure that the wage data for pension and postretirement benefit costs reported in future Medicare cost reports are accurate, supportable, and in compliance with Medicare requirements.

In written comments on the draft report, the Medical Center disagreed with our findings and recommendations. After reviewing applicable Federal regulations and guidelines and the Medical Center's comments on our draft report, we continue to believe that our findings and recommendations are valid.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or Lori A. Ahlstrand, Regional Inspector General for Audit Services, Region IX, at (415) 437-8360. Please refer to report number A-09-06-00027.

Attachment



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

SEP 15 2006

Office of Audit Services  
Region IX  
50 United Nations Plaza, Room 171  
San Francisco, CA 94102

Report Number: A-09-06-00027

Ms. Stephanie Burke  
Director, Audit & Management Advisory Services  
University of California, San Diego Medical Center  
Torrey Pines Center South, Suite 346  
LaJolla, California 92093-0919

Dear Ms. Burke:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of University of California, San Diego Medical Center's Reported Fiscal Year 2004 Wage Data." A copy of this report will be forwarded to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action 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, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent the information is not subject to exemptions in the Act that the Department chooses to exercise (see 45 CFR part 5).

Please refer to report number A-09-06-00027 in all correspondence.

Sincerely,

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

Lori A. Ahlstrand  
Regional Inspector General  
for Audit Services

Enclosures

**Direct Reply to HHS Action Official:**

Jeff Flick  
Regional Administrator  
Centers for Medicare & Medicaid Services, Region IX  
Department of Health and Human Services  
75 Hawthorne Street, Fourth Floor  
San Francisco, California 94105

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF UNIVERSITY OF  
CALIFORNIA, SAN DIEGO  
MEDICAL CENTER'S REPORTED  
FISCAL YEAR 2004 WAGE DATA**



Daniel R. Levinson  
Inspector General

September 2006  
A-09-06-00027

# ***Office of Inspector General***

<http://oig.hhs.gov>

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In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR part 5.)

## **OAS FINDINGS AND OPINIONS**

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.



## **EXECUTIVE SUMMARY**

### **BACKGROUND**

Under the inpatient prospective payment system for acute care hospitals, Medicare Part A pays hospitals at predetermined, diagnosis-related rates for patient discharges. The Centers for Medicare & Medicaid Services (CMS) adjusts hospital payments by the wage index applicable to the area in which each hospital is located.

CMS calculates a wage index for each core-based statistical area (CBSA) and one statewide rural wage index per State for areas that lie outside CBSAs. CMS will base the fiscal year (FY) 2007 wage indexes on wage data collected from the Medicare cost reports submitted by hospitals for their FYs that began during Federal FY 2003. Hospitals must accurately report wage data for CMS to determine the equitable distribution of payments and ensure the appropriate level of funding to cover hospitals' costs of furnishing services.

University of California, San Diego Medical Center (the Medical Center) reported wage data of \$249.7 million and 6 million hours in its FY 2004 Medicare cost report, which resulted in an average hourly wage rate of \$41.74. The \$41.74 average hourly wage rate is the quotient of \$249.7 million (numerator) divided by 6 million hours (denominator). Arriving at the final numerator and denominator in this rate computation involves a series of calculations. Therefore, inaccuracies in either the dollar amounts or hours reported may have varying effects on the final rate computation. Our review covered the \$53.6 million reported as pension and postretirement benefit costs.

As of FY 2005, the wage index for one California CBSA applied to the Medical Center and 17 other hospitals. Because the Medical Center's FY 2004 began during Federal FY 2003, CMS will use the FY 2004 Medicare cost report to develop the FY 2007 wage index.

### **OBJECTIVE**

Our objective was to determine whether the Medical Center complied with Medicare requirements for reporting wage data for pension and postretirement benefit costs in its FY 2004 Medicare cost report.

### **SUMMARY OF FINDINGS**

The Medical Center did not fully comply with Medicare requirements for reporting wage data for pension and postretirement benefit costs in its FY 2004 Medicare cost report. Specifically, the Medical Center reported the following inaccurate data, which affected the numerator of the wage rate calculation:

- overstated pension costs, which overstated wage data by \$22,185,436, and
- overstated postretirement benefit costs, which overstated wage data by \$25,587,883.



These errors occurred because the Medical Center did not sufficiently review and reconcile wage data to ensure that pension and postretirement benefit amounts reported were accurate, supportable, and in compliance with Medicare regulations and guidance. As a result, the Medical Center overstated its wage data by \$47,773,319 for the FY 2004 Medicare cost report period. Our correction of the Medical Center's errors reduced the average hourly wage rate approximately 19 percent from \$41.74 to \$33.75. If the Medical Center does not revise the wage data in its cost report, the applicable FY 2007 CBSA wage index will be overstated, which will result in overpayments to the Medical Center and the 17 other hospitals that use this wage index.

## **RECOMMENDATIONS**

We recommend that the Medical Center:

- submit a revised FY 2004 Medicare cost report to the fiscal intermediary to correct the overstated pension and postretirement benefit wage data totaling \$47,773,319 and
- implement review and reconciliation procedures to ensure that the wage data for pension and postretirement benefit costs reported in future Medicare cost reports are accurate, supportable, and in compliance with Medicare requirements.

## **MEDICAL CENTER'S COMMENTS**

In written comments on the draft report, the Medical Center disagreed with our findings and recommendations. The Medical Center stated that it reported pension and postretirement benefit costs in accordance with generally accepted accounting principles (GAAP) as instructed by CMS in the September 1, 1994, Federal Register notice (59 Federal Register 45357). Further, the Medical Center stated that the June 2003 changes to the "Medicare Provider Reimbursement Manual" (the Manual), which required compliance with Medicare's reasonable cost provisions, were ambiguous and did not change the 1994 policy. The Medical Center also stated that the August 12, 2005, Federal Register changed, rather than clarified, CMS's policy by requiring timely liquidation of pension and postretirement benefit accruals. Therefore, the Medical Center concluded that we made our recommended adjustments to the cost report based on a policy change implemented after the audit period.

We included the full text of the Medical Center's comments as Appendix B. We did not include the exhibits attached to the Medical Center's comments because they are summarized in Appendix B and some contain proprietary information.

## **OFFICE OF INSPECTOR GENERAL'S RESPONSE**

Although we agree that the Medical Center calculated pension and postretirement benefit costs in accordance with GAAP, it did not report these costs in accordance with Medicare requirements. The Manual, part II, section 3605.2, states that hospitals should use GAAP to develop wage-related costs; however, the amount reported for wage index purposes must also meet Medicare reasonable cost principles. CMS issued this Manual instruction, requiring the

application of Medicare reasonable cost principles for wage index cost reporting, in June 2003. It was, therefore, operative during the audit period.

We understand that the Medical Center did not contribute to the pension trust fund because the plan was fully funded. However, because the plan was fully funded, the Medical Center did not incur a cost or liability to record in its general ledger. In addition, the Medical Center does not have a trust fund for postretirement benefits and therefore does not make contributions to fund future liabilities. Accordingly, the pension and postretirement liability costs that were actuarially determined in accordance with GAAP were not funded or liquidated within 1 year of the Medical Center's cost reporting period, as required by Medicare.

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## **INTRODUCTION**

### **BACKGROUND**

#### **Medicare Inpatient Prospective Payment System**

Under the inpatient prospective payment system for acute care hospitals, Medicare Part A pays hospital inpatient costs at predetermined, diagnosis-related rates for patient discharges. Medicare Part B, on the other hand, pays for medical costs such as physicians' services rendered to patients, clinical laboratory services, and outpatient hospital services.

In fiscal year (FY) 2005, according to the Centers for Medicare & Medicaid Services (CMS), Medicare Part A expects to pay 3,900 acute care hospitals about \$105 billion, an increase of about \$5 billion over FY 2004.

#### **Wage Indexes**

The geographic designation of hospitals influences their Medicare payments. Under the hospital inpatient prospective payment system, CMS adjusts payments through a wage index to reflect labor cost variations among localities. CMS uses the Office of Management and Budget (OMB) metropolitan area designations to identify labor markets and to calculate and assign wage indexes to hospitals. In 2003, OMB revised its metropolitan statistical area definitions and announced new core-based statistical areas (CBSA). CMS calculates a wage index for each CBSA and one statewide rural wage index per State for areas that lie outside CBSAs. The wage index for each CBSA and the statewide rural area is based on the average hourly wage rate of the hospitals in those areas divided by the national average hourly wage rate. All hospitals within a CBSA or within a statewide rural area receive the same labor payment adjustment.

To calculate wage indexes, CMS uses hospital wage data (which include wages, salaries, and related hours) collected 4 years earlier to allow time for the cost report settlement process and CMS's data review. Accordingly, wage data collected from the Medicare cost reports submitted by hospitals for their FYs that began during Federal FY 2003 will be used to calculate wage index values for FY 2007. A hospital's wage rate is the quotient of dividing total dollars (numerator) by total hours (denominator). Arriving at the final numerator and denominator in this rate computation involves a series of calculations. Therefore, inaccuracies in either the dollar amounts or hours reported may have varying effects on the final rate computation.

Hospitals must accurately report wage data for CMS to determine the equitable distribution of payments and ensure the appropriate level of funding to cover hospitals' costs of furnishing services. Section 1886(d)(3)(E) of the Social Security Act requires that CMS update the wage indexes annually in a manner that ensures that aggregate payments to hospitals are not affected by changes in the indexes.

## **University of California, San Diego Medical Center**

University of California, San Diego Medical Center (the Medical Center) provides acute care hospital services through its two facilities located in San Diego and La Jolla, California. As of FY 2005, the wage index for one California CBSA applied to the Medical Center and 17 other hospitals. Because the Medical Center's FY 2004 began during Federal FY 2003, CMS will use the FY 2004 Medicare cost report to develop the FY 2007 wage index.

### **OBJECTIVE, SCOPE, AND METHODOLOGY**

#### **Objective**

Our objective was to determine whether the Medical Center complied with Medicare requirements for reporting wage data for pension and postretirement benefit costs in its FY 2004 Medicare cost report.

#### **Scope**

The Medical Center reported wage data of \$249.7 million and 6 million hours to CMS on Worksheet S-3, part II, of its FY 2004 (July 1, 2003, through June 30, 2004) Medicare cost report, which resulted in an average hourly wage rate of \$41.74. Our review covered the \$53.6 million reported as pension and postretirement benefit costs. We limited our review of the Medical Center's internal controls to the procedures that the Medical Center used to accumulate and report pension and postretirement benefit wage data for its FY 2004 Medicare cost report.

We conducted audit work from December 2005 through February 2006.

#### **Methodology**

To accomplish our objective, we:

- reviewed applicable Medicare laws, regulations, and guidance;
- obtained an understanding of the Medical Center's procedures for reporting pension and postretirement benefits wage data;
- verified that wage-related costs on the Medical Center's Worksheet S-3 reconciled to wage-related costs reported on Exhibit 7;
- obtained from the Medical Center the actual postretirement benefit costs incurred during FY 2004;
- verified whether the Medical Center reported pension and postretirement benefit costs in the FY 2004 Medicare cost report in accordance with Medicare regulations and guidance; and

- determined the effect of the reporting errors by recalculating the Medical Center’s average hourly wage rate using the CMS methodology for calculating the wage index, which includes an hourly overhead factor, in accordance with instructions published in the Federal Register. (See Appendix A.)

We conducted our review in accordance with generally accepted government auditing standards.

## **FINDINGS AND RECOMMENDATIONS**

The Medical Center did not fully comply with Medicare requirements for reporting wage data for pension and postretirement benefit costs in its FY 2004 Medicare cost report. Specifically, the Medical Center reported the following inaccurate data, which affected the numerator of the wage rate calculation:

- overstated pension costs, which overstated wage data by \$22,185,436, and
- overstated postretirement benefit costs, which overstated wage data by \$25,587,883.

These errors occurred because the Medical Center did not sufficiently review and reconcile wage data to ensure that pension and postretirement benefit amounts reported were accurate, supportable, and in compliance with Medicare regulations and guidance. As a result, the Medical Center overstated its wage data by \$47,773,319 for the FY 2004 Medicare cost report period. Our correction of the Medical Center’s errors reduced the average hourly wage rate approximately 19 percent from \$41.74 to \$33.75. If the Medical Center does not revise the wage data in its cost report, the applicable FY 2007 CBSA wage index will be overstated, which will result in overpayments to the Medical Center and the 17 other hospitals that use this wage index.<sup>1</sup>

### **MEDICARE REQUIREMENTS FOR REPORTING PENSION AND POSTRETIREMENT BENEFIT COSTS**

The “Medicare Provider Reimbursement Manual” (the Manual), part II, section 3605.2, states:

For purposes of determining the wage related costs for the wage index, a hospital must use generally accepted accounting principles (GAAP) . . . . Although hospitals should use GAAP in developing wage related costs, the amount reported for wage index purposes must meet the reasonable costs provisions of Medicare.

The principles of reasonable cost reimbursement are found in 42 CFR part 413. Pursuant to 42 CFR § 413.100(c)(2)(vii)(A): “Reasonable provider payments made under unfunded deferred compensation plans are included in allowable costs only during the cost reporting period in which actual payment is made to the participating employee.” Also, 42 CFR § 413.100(c)(2)(vii)(B)

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<sup>1</sup>The extent of overpayments cannot be determined until CMS finalizes its FY 2007 wage indexes.

states: “Accrued liability related to contributions to a funded deferred compensation plan must be liquidated within 1 year after the end of the cost reporting period in which the liability is incurred.” Further, 42 CFR § 413.100(c)(2)(vii)(C) states: “Postretirement benefit plans . . . are deferred compensation arrangements and thus are subject to the provisions of this section regarding deferred compensation and to applicable program instructions . . . .”

## **ERRORS IN REPORTED WAGE DATA**

The Medical Center overstated its wage-related costs by reporting overstated pension and postretirement benefit costs in its FY 2004 Medicare cost report. As a result, the Medical Center overstated its wage data by \$47,773,319, which overstated its average hourly wage rate by \$7.99. The errors in reported wage data are discussed in detail below, and the cumulative effect of the findings is presented in Appendix A.

### **Overstated Pension Costs**

The Medical Center erroneously reported, as wage-related cost, \$23,275,442 of the \$23,704,892 of actuarially determined pension costs. The \$23,704,892 represented the Medical Center’s portion of the University of California’s (the University’s) defined benefit contribution pension costs that were actuarially determined in accordance with GAAP. The University’s pension plan was funded by member and employer contributions and by investment income. However, the University did not make employer contributions to the pension plan during FY 2004 because the plan was already fully funded. Consequently, the Medical Center did not fund the actuarially determined portion of the University’s pension plan costs or record the costs in its general ledger. Because the Medical Center did not record a contribution or pension cost liability, it should not have reported the actuarially determined pension costs as wage-related costs in its Medicare cost report. The inclusion of those costs, after various adjustments, overstated wage data by \$22,185,436, which overstated its average hourly wage rate by \$3.71.

### **Overstated Postretirement Benefit Costs**

The Medical Center erroneously reported, as wage-related cost, \$30,315,653 of the \$30,810,965 of actuarially determined postretirement benefit costs. The \$30,810,965 represented the Medical Center’s portion of the University’s postretirement benefit costs that were actuarially determined for all University medical centers. The actuarial report was prepared in accordance with GAAP and was developed solely for the medical centers’ use in completing their Medicare cost reports. The University did not have a trust fund for postretirement benefits. Instead, the University paid postretirement benefit costs as they were incurred. For FY 2004, the Medical Center’s share of the University’s postretirement benefit costs was \$3,470,596. Because the actuarially determined postretirement costs were not incurred in their entirety, as required by Medicare, the Medical Center should have reported only \$3,470,596 of actual postretirement benefits paid. As a result, the Medical Center overstated its wage data by \$25,587,883 after various adjustments, which overstated its average hourly wage rate by \$4.28.

## **CAUSES OF WAGE DATA REPORTING ERRORS**

The errors in reported wage data occurred because the Medical Center did not sufficiently review and reconcile wage data to ensure that pension and postretirement benefit amounts reported were accurate, supportable, and in compliance with Medicare regulations and guidance.

## **OVERSTATED WAGE DATA AND POTENTIAL OVERPAYMENTS**

As a result of the reporting errors, the Medical Center overstated its wage data by \$47,773,319 for the FY 2004 Medicare cost report period. Our correction of the Medical Center's errors reduced the average hourly wage rate approximately 19 percent from \$41.74 to \$33.75. If the Medical Center does not revise the wage data in its cost report, the applicable FY 2007 CBSA wage index will be overstated, which will result in overpayments to the Medical Center and the 17 other hospitals that use this wage index.

## **RECOMMENDATIONS**

We recommend that the Medical Center:

- submit a revised FY 2004 Medicare cost report to the fiscal intermediary to correct the overstated pension and postretirement benefit wage data totaling \$47,773,319 and
- implement review and reconciliation procedures to ensure that the wage data for pension and postretirement benefit costs reported in future Medicare cost reports are accurate, supportable, and in compliance with Medicare requirements.

## **MEDICAL CENTER'S COMMENTS**

The Medical Center disagreed with our findings and recommendations. The Medical Center stated that it reported pension and postretirement benefit costs in accordance with GAAP as instructed by CMS in the September 1, 1994, Federal Register. Further, the Medical Center stated that the June 2003 changes to the Manual, which required compliance with Medicare's reasonable cost provisions, were ambiguous and did not change the 1994 policy. The Medical Center also stated that the August 12, 2005, Federal Register changed, rather than clarified, CMS's policy by requiring timely liquidation of pension and postretirement benefit accruals. Therefore, the Medical Center concluded that we made our recommended adjustments to the cost report based on a policy change implemented after the audit period.

Regarding pension costs, the Medical Center stated that it reported these costs in accordance with GAAP and Financial Accounting Standard (FAS) 87 as instructed by CMS in the September 1, 1994, Federal Register notice (59 Federal Register 45357). The Medical Center also stated that the instructions in the 2005 Federal Register applied to unfunded plans, especially those that would never be funded, not to funded plans. Accordingly, the Medical Center concluded that, for a fully funded plan, there is no rational basis for excluding the actuarially determined FAS 87 pension costs for wage reporting purposes.



Regarding postretirement benefit costs, the Medical Center stated that it reported these costs in accordance with GAAP and FAS 106 as instructed by CMS in the September 1, 1994, Federal Register notice (59 Federal Register 45357). The Medical Center agreed that its postretirement benefit plan is not a funded plan and that it did not make contributions in advance to fund future liabilities. However, the Medical Center stated that it followed GAAP rather than Medicare cost principles to report FY 2004 costs for wage index purposes. Further, the Medical Center stated that, because CMS issued the instructions in the August 12, 2005, Federal Register, nearly a year after the Medical Center filed its FY 2004 Medicare cost report, it is inappropriate for us to recommend that the Medical Center retroactively alter the methodology for reporting postretirement benefit costs. The Medical Center also asserted that its Fiscal Intermediary approved the reporting methodology.

We included the full text of the Medical Center's comments as Appendix B. We did not include the exhibits attached to the Medical Center's comments because they are summarized in Appendix B and some contain proprietary information.

## **OFFICE OF INSPECTOR GENERAL'S RESPONSE**

Although we agree that the Medical Center calculated pension and postretirement benefit costs in accordance with GAAP, it did not report these costs in accordance with Medicare requirements. The Manual, part II, section 3605.2, states that hospitals should use GAAP to develop wage-related costs; however, the amount reported for wage index purposes must also meet Medicare reasonable cost principles. CMS issued this Manual instruction, requiring the application of Medicare reasonable cost principles for wage index cost reporting, in June 2003. It was, therefore, operative during the audit period. (The August 12, 2005, Federal Register notice repeated this instruction. Specifically, the Federal Register, page 47369, stated:

. . . we [CMS] are clarifying in this final rule that hospitals must comply with the requirements in 42 CFR § 413.100 . . . and related Medicare program instructions for developing pension and other deferred compensation plan costs as wage-related costs for the wage index.)

Regarding pension costs, we understand that the Medical Center was not required to make contributions to the pension trust fund because the plan was fully funded. The Medicare reasonable cost principle at section 413.100(c)(2)(vii)(B) allows "accrued liability related to contributions to a funded deferred compensation plan," provided that the liability is timely liquidated. However, because no actual obligation existed and the Medical Center made no contribution, no accrued pension costs should have been reported in the FY 2004 Medicare cost report. (We agree that the 2005 Federal Register did not specifically address overfunded plans, but nor did it exclude such plans from the requirement that wage index costs be reported consistent with section 413.100.)

Regarding postretirement benefit costs, the Medical Center was required under section 3605.2 of the Manual to follow Medicare cost principles for reporting wage index data. The applicable cost principle, at section 413.100(c)(2)(vii)(A), provides, "Reasonable provider payments made

under unfunded deferred compensation plans are included in allowable costs only during the cost reporting period in which actual payment is made to the participating employee.” The Medical Center reported an amount that exceeded its actual payments by more than \$25 million.

# **APPENDIXES**

## CUMULATIVE EFFECT OF FINDINGS

Components		Reported Medical Center's Fiscal Year 2004 Wage Data	Overstated Pension Costs	Overstated Postretirement Benefit Costs	Total Adjustment for Medical Center's Fiscal Year 2004 Wage Data
University of California, San Diego Medical Center					
<i>Worksheet S - 3, Part II</i>					
<b>Total Salaries</b>					
line 1/col. 3	Total Salaries	\$190,271,698.00			\$190,271,698.00
<b>Excluded Salaries</b>					
line 4.01/col. 3	Teaching Physician				
line 5/col. 3	Physician Part B				
line 5.01 col. 3	Non-physician Part B				
line 6/col. 3	Interns and Residents	\$19,712,160.00			\$19,712,160.00
line 6.01/col.3	Contract Services - Interns and Residents				
line 7/col.3	Home Office Personnel				
line 8/col. 3	Skilled Nursing Facility (SNF)				
line 8.01/col. 3	Excluded Area	\$14,253,576.00			\$14,253,576.00
subtotal (subtract)		\$33,965,736.00	\$0.00	\$0.00	\$33,965,736.00
<b>Additional Salaries</b>					
line 9/col. 3	Contract Labor	\$10,505,559.00			\$10,505,559.00
line 10/col. 3	Contract Labor - Physician Part A				
line 10.01/col.3	Contract Labor - Teaching Physician				
line 11/col. 3	Home Office				
line 13/col. 3	Wage-Related Cost (Core)	\$90,521,132.00	(\$22,845,992.00)	(\$26,349,745.00)	\$41,325,395.00
line 14/col. 3	Wage-Related Cost (Other)				
line 18/col. 3	Wage-Related Cost - Physician Part A				
subtotal (add)		\$101,026,691.00	(\$22,845,992.00)	(\$26,349,745.00)	\$51,830,954.00
	Adjusted Salaries	\$257,332,653.00	(\$22,845,992.00)	(\$26,349,745.00)	\$208,136,916.00
<b>Total Paid Hours</b>					
line 1/col. 4	Total Hours	7,385,862.00			7,385,862.00
<b>Excluded Hours</b>					
line 4.01/col. 4	Teaching Physician				
line 5/col. 4	Physician Part B				
line 5.01/col. 4	Non-physician Part B				
line 6/col. 4	Interns and Residents	927,587.00			927,587.00
line 6.01/col. 4	Contract Services - Interns and Residents				
line 7/col. 4	Home Office Personnel				
line 8/col. 4	Skilled Nursing Facility (SNF)				
line 8.01/col. 4	Excluded Area	490,171.00			490,171.00
subtotal (subtract)		1,417,758.00	0.00	0.00	1,417,758.00
<b>Additional Hours</b>					
line 9/col. 4	Contract Labor	199,959.00			199,959.00
line 10/col. 4	Contract Labor - Physician Part A				
line 10.01/col.4	Contract Labor - Teaching Physician				
line 11/col. 4	Home Office				
subtotal (add)		199,959.00	0.00	0.00	199,959.00
	Adjusted Hours	6,168,063.00	0.00	0.00	6,168,063.00

Components		Reported Medical Center's Fiscal Year 2004 Wage Data	Overstated Pension Costs	Overstated Postretirement Benefit Costs	Total Adjustment for Medical Center's Fiscal Year 2004 Wage Data
University of California, San Diego Medical Center					
<i>Worksheet S - 3, Part III</i>					
<b>Overhead Allocation</b>					
line13/col. 3	Total Overhead Salaries	\$48,285,348.00			\$48,285,348.00
line13/col. 4	Total Overhead Hours	1,781,587.00			1,781,587.00
	Total Hours	7,385,862.00			7,385,862.00
	Less:				
	Teaching Physician Hours	0.00	0.00	0.00	0.00
	Physician Part B Hours	0.00	0.00	0.00	0.00
	Non-physician Part B Hours	0.00	0.00	0.00	0.00
	Interns and Residents Hours	927,587.00	0.00	0.00	927,587.00
	Total Overhead Hours	1,781,587.00	0.00	0.00	1,781,587.00
	Subtotal	2,709,174.00	0.00	0.00	2,709,174.00
	Revised Hours	4,676,688.00	0.00	0.00	4,676,688.00
	Overhead Reduction For Excluded Area Hours				
	SNF Hours	0.00	0.00	0.00	0.00
	Excluded Area Hours	490,171.00	0.00	0.00	490,171.00
	Subtotal	490,171.00	0.00	0.00	490,171.00
	Excluded Overhead Rate [(SNF+Excluded Area Hours)/Revised Hours]	0.104811568	0.000000	0.000000	0.104811568
	Excluded Overhead Salaries (Overhead Salaries * Excluded Overhead Rate)	\$5,060,863.01	\$0.00	\$0.00	\$5,060,863.01
	Excluded Overhead Hours (Overhead Hours * Excluded Overhead Rate)	186,730.93	0.00	0.00	186,730.93
	Overhead Rate (Overhead Hours/Revised Hours + Overhead Hours)	0.27586112	0.000000	0.000000	0.27586112
	Wage-Related Cost (Core)	\$90,521,132.00	(\$22,845,992.00)	(\$26,349,745.00)	\$41,325,395.00
	Wage-Related Cost (Other)	\$0.00	\$0.00	\$0.00	\$0.00
	Wage-Related Cost - Physician Part A	\$0.00	\$0.00	\$0.00	\$0.00
	Total Wage-Related Cost	\$90,521,132.00	(\$22,845,992.00)	(\$26,349,745.00)	\$41,325,395.00
	Overhead Wage-Related Cost	\$24,971,261.21	(\$6,302,321.03)	(\$7,268,870.27)	\$11,400,069.91
	Excluded Wage-Related Cost	\$2,617,277.03	(\$660,556.15)	(\$761,861.69)	\$1,194,859.19
	Adjusted Salaries	\$257,332,653.00	(\$22,845,992.00)	(\$26,349,745.00)	\$208,136,916.00
	Less: Excluded Overhead Salaries	\$5,060,863.01	\$0.00	\$0.00	\$5,060,863.01
	Excluded Wage-Related Cost	\$2,617,277.03	(\$660,556.15)	(\$761,861.69)	\$1,194,859.19
	Revised Wages	\$249,654,512.96	(\$22,185,435.85)	(\$25,587,883.31)	\$201,881,193.80
	Multiply By : Inflation Factor	1.00			1.00
	Inflated Wages (Adjusted Wages Used In Report)	\$249,654,512.96	(\$22,185,435.85)	(\$25,587,883.31)	\$201,881,193.80
	Revised Hours (Adjusted Hours Used In Report)	5,981,332.07	0.00	0.00	5,981,332.07
	[Adjusted Hours - Excluded Overhead Hours]				
	Average Hourly Wage	\$41.74	(\$3.71)	(\$4.28)	\$33.75

Total Wage Data Revisions: (Rounded)

Total

Inflated Wages	(\$22,185,436)	(\$25,587,883)	(\$47,773,319)
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March 29, 2006

FILE NO. 88152-907

## VIA FEDERAL EXPRESS

Lori Ahlstrand  
 HHS, Office of Inspector General  
 50 United Nations Plaza  
 San Francisco, CA 94102

Re: UC Davis Medical Center ("UCD"), Provider No. 05-0599  
 UCI Medical Center ("UCI"), Provider No. 05-0348  
 UCLA Medical Center ("UCLA"), Provider No. 05-0262  
 UCSD Medical Center ("UCSD"), Provider No. 05-0025  
 UCSF Medical Center ("UCSF"), Provider No. 05-0454

FYE: 6/30/04  
 OIG Draft Reports on Reported Fiscal Year 2004 Wage Data

Dear Ms. Ahlstrand:

On behalf of the five University of California Medical Centers (the "UC Med Centers" or the "Med Centers") listed above, we are writing in response to the Draft Reports of the Department of Health and Human Services' Office of Inspector General ("OIG") with respect to reported fiscal year 2004 wage data.<sup>1</sup> Solely as a result of the OIG's Draft Reports (or, in some

<sup>1</sup> The OIG has issued five separate reports for the five UC campuses, with the following dates: February 15, 2006 for UCSF; March 2, 2006 for UCD; March 3, 2006 for UCLA; March 8, 2006 for UCSD, and March 28, 2006 for UCI. The OIG has graciously granted UCSF an extension of time to March 30, 2006 in which to submit a response to the OIG Draft Report. Since all five Draft Reports are identical with respect to the proposed elimination of pension and postretirement benefit costs for Medicare wage index purposes, the University of California ("UC" or "University") submits this consolidated response. To the extent necessary, please (footnote continued)

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instances, preliminary findings that preceded Draft Reports), the UC Med Centers' fiscal intermediary, United Government Services, LLC. ("UGS" or the "Intermediary"), has proposed the near complete elimination of pension and postretirement benefit costs on the Medicare cost report for the Med Centers' fiscal year ending ("FYE") June 30, 2004, for purposes of developing the Medicare wage index for the federal fiscal year ending September 30, 2007 ("FFY 2007 Wage Index").<sup>2</sup> Though the actual proposed adjustment amounts vary from facility to facility, the basis for the proposed adjustments is identical for all five Med Centers. *See* Exhibit 1 (UCSF), Exhibit 2 (UCD), Exhibit 3 (UCLA), Exhibit 4 (UCI), and Exhibit 5 (UCSD). Please note that all exhibits associated with this letter are set forth in two separately (and spirally) bound volumes.

In a 25-exhibit submission dated March 10, 2006, the UC Med Centers sought a reversal of the Intermediary's proposed adjustments to eliminate nearly all pension cost and postretirement benefit cost. *See* Exhibit 26 (the March 10 letter without exhibits).<sup>3</sup> Instead of responding to the substance of the UC Med Centers' March 10 submission, the Intermediary simply indicated that it is "required to follow any instructions given to us by OIG and/or CMS." *See* Exhibit 27.<sup>4</sup> Given that UGS appears to be awaiting further "instructions" from the OIG or

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consider this response to be the response of each of the five UC Med Centers to their respective individual OIG Draft Reports.

<sup>2</sup> The adjustments for UCSF and UC Davis were made by the UGS branch in Oakland, California. The adjustments for UCLA, UCI and UCSD were made by the UGS branch in Camarillo, California. Because the various audit teams involved at both branches acted identically in their determinations of the adjustments mentioned in this letter, we will refer to the two branches, and the various audit teams involved, collectively as UGS or the Intermediary.

<sup>3</sup> The UC March 10 submission is largely the same as this submission. In particular, the first 25 exhibits to this letter were likewise submitted to UGS as part of the UC's March 10 letter to UGS.

<sup>4</sup> Exhibit 27 includes all five UGS responses. They vary slightly but not substantively. Four of the five UGS letters make it quite clear that no independent review was performed, no analysis conducted, and that UGS solely relied on preliminary or draft OIG findings as if they were some kind of "instruction" to make the pension and postretirement benefit cost disallowances. The fifth UGS letter, the UGS response for UCSF, suggests unconvincingly that even though "we are required to follow any instructions give to us by OIG", the Intermediary "performed [a] review based on the documents submitted, and concurred with OIG's findings on Pension and Post Retirement adjustment [sic]." Exhibit 27 (UGS response for UCSF). This letter fails to indicate which documents were reviewed, i.e., the documents during audit or the documents in the March 10 package. Either way, given that: 1) this letter was issued 11 days after UGS received the 25 exhibit package, 2) the one page letter offers no rationale or reasoning, (footnote continued)

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the Centers for Medicare and Medicaid Services ("CMS"), it is imperative that the OIG issue a final report that adequately responds to this letter (and the attached exhibits) well before the FFY 2007 Wage Index is finalized. Essentially, the UC needs a reasoned response to this package on or before April 28, 2006. This is because CMS has extremely limited time to issue its findings on any wage index appeal of an intermediary determination. Yet, CMS too might be waiting for the OIG's view. Indeed, apparently, CMS's new approach to pension cost accounting for wage index purposes stems from the OIG's audit activity over the past few years. 70 Fed. Reg. 23306, 23371 (May 4, 2005) (Exhibit 10).

For the record, though, the UC Med Centers strongly object to the Intermediary's blanket reliance on the OIG's findings, which are not final and, in the opinion of the Med Centers, are erroneous. Indeed, the OIG should expressly indicate in its reports (draft or otherwise) that an intermediary should not make adjustments to a Medicare provider's costs solely based on OIG recommendations to a provider. Instead, if the provider does not follow through on the OIG's recommendations, the only appropriate approach is for an intermediary to independently audit. The OIG is not the appropriate body to audit a Medicare provider's costs and cannot substitute for the requisite independent intermediary audit process.

Significantly, the UC Med Centers object to the OIG's Pension and Postretirement Benefits findings in their entirety. Further, UCSF objects to various other wage, salary, and hours finding in the OIG Draft Report for UCSF.

The UC Med Centers believe that, with one minor exception, they properly reported their pension and postretirement benefit costs on the wage survey portion of their cost reports for FYE 6/30/2004 (the "2004 Wage Survey") and that no revisions should be required.<sup>5</sup> Thus, the Med

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and 3) the other three UGS responses suggest (accurately) that no independent review was performed, it seems quite unlikely that UGS performed some kind of special independent review just for UCSF. Finally, UGS seems to refer to the OIG draft or preliminary findings as "instructions" to UGS. Rather, the OIG has so far only issued preliminary or draft recommendations to the UC Med Centers. See, e.g., Exhibit 6 through 9. There have not been any OIG instructions to UGS. Indeed, the OIG's function and mission simply do not include instructing an intermediary to make any type of audit adjustment.

<sup>5</sup> The one exception is UCI, which inadvertently reported its 2003 pension and postretirement benefit costs, rather than its 2004 costs, on the 2004 Wage Survey. While the OIG findings on, and UGS proposed adjustments to, UCI's wage data should be reversed, the reported pension and postretirement benefit costs should be adjusted to reconcile to the actuarially-determined figures for the correct time period (FY 2004). See *infra* Section on UCI Adjustments.



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Centers request that the OIG reverse its findings on the pension and postretirement benefit cost issue for all five UC campuses.

As explained below, the OIG has mistakenly failed to recognize that the Med Centers reported both their pension and their postretirement benefit costs on the 2004 Wage Survey consistent with the policies for reporting of wage related costs that were in effect at the time that the 2004 Wage Survey was completed. In fact, the methodology used to report those costs on the 2004 Wage Survey was previously approved by UGS as consistent with contemporaneous CMS policy after careful review and detailed discussions with the Med Centers and CMS. Further, even after the change in policy regarding reporting of wage related costs for wage index purposes that was set forth by CMS in the proposed and final Inpatient PPS Rules for FY 2006, which admittedly will appear to affect the Med Centers' reporting of postretirement benefit cost in future wage index surveys, the methodology used by the Med Centers to report Pension Cost remains correct. Additionally, the proposed pension and postretirement benefit adjustments would be unfair, and inconsistent with CMS's longstanding policy, in that the proposed adjustments reflect a retroactive change in the policies that govern how these wage related costs should be reported.

#### **Background on the Reporting of Wage-Related Costs for Wage Index**

The rules governing how providers were supposed to report wage-related costs on Worksheet S-3, Part II for purposes of the hospital wage index were established by CMS in a discussion in the Preamble to the Final Inpatient PPS Rule for FY 1995, published in the September 1, 1994 Federal Register. 59 Fed. Reg. 45330, 45357-59 (Sept. 1, 1994). A copy, along with other relevant Federal Register excerpts, is attached at Exhibit 10. In this discussion, CMS made it absolutely clear that there would be a divergence in how wage-related costs would be reported for Medicare cost reimbursement purposes as compared to how they should be reported for Medicare wage index purposes. CMS stated that Generally Accepted Accounting Principles ("GAAP") should be followed when reporting costs on Worksheet S-3, Part II, whereas the use of applicable Medicare principles for determining fringe benefits for all other purposes would remain unchanged. This made it clear that, in some instances, treatment of a cost under GAAP would differ from treatment of a cost under Medicare principles. Thus, since that 1994 issuance, providers could, and did, look to the clear rules found in GAAP for determining how to report costs associated with pensions and postretirement benefits on Worksheet S-3, Part II for the annual wage survey.

While this remained the only clear guidance on the issue until 2005, CMS has suggested that a minor revision to the cost report instructions in Section 3605.2 of Part II of the Provider Reimbursement Manual by Transmittal 10 in June 2003 is applicable to the reporting of pension and postretirement benefit costs on the wage survey. The revised PRM II provision, with the added language highlighted, is attached as Exhibit 11. With this transmittal, the instructions for Lines 13-20 of Worksheet S-3, Part II continued to provide a distinction between the use of GAAP for wage index reporting and the use of Medicare principles for cost reporting, as follows:

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For purposes of determining the wage-related costs for the wage index, a hospital must use generally accepted accounting principles (GAAP). (Continue to use Medicare principles on all other areas to determine allowable fringe benefits.)

CMS then added the following language to a Note to the instructions :

Although hospitals should use GAAP in developing wage related costs, the amount reported for wage index purposes must meet the reasonable costs provisions of Medicare. For example, the cost reported for self insurance must not exceed the costs of available commercial insurance (see PRM, Part I, §2162).

In a recent Federal Register discussion, addressed below, CMS suggests that this addition in the Note to the Worksheet S-3, Part II instructions clarified the wage related cost policy that had been in effect since 1994, as applied to the reporting of pension costs. Specifically, CMS suggested in the August 12, 2005 Federal Register that the additional note somehow clarified that only pension plan costs that meet the timely liquidation requirements of Medicare cost reimbursement principles can be claimed for wage index purposes. *See* Exhibit 10. Yet, the additional note neither mentions pensions nor liquidation of liability.

The Medical Centers strongly contest the idea that this sentence placed in the cost report instructions had the effect of clarifying or changing longstanding policy for reporting pension cost. First, the overall policy, stated at the beginning of the instruction, that GAAP should be used for wage index purposes and Medicare principles for all other purposes, remains in the instruction. The newly added note is ambiguous, far from clear in its meaning or in how it was changing or clarifying the overriding policy. The example given, i.e., a "prudent buyer" concept for self-insurance, is inapplicable to pension or postretirement benefit costs. From this example, it would not be apparent to anyone that this sentence, slipped into a note to the cost report instructions, was somehow supposed to change or clarify longstanding policy regarding the reporting of pension and postretirement benefits on the wage survey.

Further, from a "legal" standpoint, if this were a change, it was only published in the PRM-II, which sets forth "sub-regulations." The existing policy had been set forth in the Federal Register as part of the Inpatient PPS Rule. Though it was not included in actual regulations, its placement in the Preamble to the PPS regulations gives it a legal impact far more significant than manual provisions (especially Part II of the PRM). Therefore, the policy could not be changed through a revision (especially an ambiguous one) in the PRM-II.

The rules for reporting pension and postretirement benefit costs for wage index purposes were explicitly addressed by CMS last year in the proposed and final Inpatient PPS Rules for FY 2006. *See* 70 Fed. Reg. at 23371 and 70 Fed. Reg. 47278, 47368-70 (Aug. 12, 2005), included collectively in Exhibit 10. In the proposed rule, CMS stated:

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Due to recent questions and concerns we received regarding inconsistent reporting and overreporting of pension and other deferred compensation plan costs, as a result of an ongoing Office of Inspector General review, we are clarifying in this proposed rule that hospitals must comply with the PRM, Part I, sections 2140, 2141, and 2142 and related Medicare program instructions for developing pension and other deferred compensation plan costs as wage-related costs for the wage index. The Medicare instructions for pension costs and other deferred compensation costs combine GAAPs, Medicare payment principles, and other Federal labor requirements. We believe that the Medicare instructions allow for consistent reporting among hospitals and for the development of reasonable deferred compensation plan costs for purposes of the wage index.

Beginning with the FY 2007 wage index, hospitals and fiscal intermediaries must ensure that pension, post-retirement health benefits, and other deferred compensation plan costs for the wage index are developed according to the above terms.

Although CMS used the words "we are clarifying," this is clearly meant to be a change to prior policy. Exactly what was meant by the change indicating that PRM provisions must be followed was not clear, especially since CMS indicated that Medicare principles include GAAP. CMS was somewhat clearer in the more detailed discussion in the Final Rule. Notably, CMS did not mention the 2003 change to the cost reporting instructions in the discussion in the Proposed Rule, further indication that this minor 2003 addition to PRM-II, Section 3605.2 did not represent a change or a clarification with respect to the treatment of pension costs.

CMS went into greater detail regarding this change in policy in the Final Rule in August 2005 (included in Exhibit 10). CMS made it clear that it had instructed hospitals in 1994 to use GAAP for reporting accrued pension and deferred compensation costs, whereas all other wage costs on Worksheet S-3 must reflect costs that are actually expended by the hospital during the cost reporting period. CMS then pointed out that a major difference between GAAP and Medicare principles is the issue of funding, referencing the requirement that liabilities must be liquidated within one year to be claimed as costs (codified in 42 C.F.R. § 413.100). CMS cited to the 2003 revision to the cost report instructions, discussed above, and claimed that it was a clarification "to ensure that a hospital includes in the wage index only those pension and other deferred compensation plan costs that meet the timely liquidation requirements for Medicare reasonable cost principles." The Preamble discussion goes on to state as follows:

When CMS issued the September 1, 1994 instructions, CMS did not anticipate nor intend for hospitals to include costs in the wage index that have not been funded and may never be funded.

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Including unfunded deferred compensation costs in the wage index can significantly misrepresent an area's hourly wage, especially if the plan is never funded.

70 Fed. Reg. at 47369.

Whatever CMS may have intended in 1994, and whatever it may have intended by its 2003 cost report instruction revision, this 2005 discussion makes it clear that CMS wants now to make sure that providers do not include pension costs in the wage survey that were unfunded and might never be funded.

After setting forth some background on the historic treatment of the UC Med Centers' pension and postretirement benefits costs, we will explain how CMS's newly stated principle applies to those costs, how they should be reported in the future, and why no adjustment should be made to these costs as reported in the 2004 Wage Survey. Significantly, the OIG Draft Reports simply ignore this history, and improperly allege that the UC Med Centers made "errors" in reporting wage data because they did "not sufficiently review and reconcile wage data to ensure that pension and postretirement benefit amounts reported were accurate, supportable, and in compliance with Medicare regulations and guidance." As the reader will soon see, quite the opposite is the case. The UC Med Centers absolutely followed the clear guidance of CMS and UGS in place at the time the FYE 6/30/04 cost reports were filed.

#### **Historic Treatment of UC Med Centers' Pension and Postretirement Benefits Costs**

The UC Med Centers pension plan (the "Pension Plan"), part of the larger University pension plan, is a defined benefit plan. *See* Financial Report for The University of California Retirement System Retirement Plan for Year Ended June 30, 2004 (Exhibit 12 at page 3). Contributions by eligible employees are made each year into the Pension Plan. Through 1990-91, the University, including the Med Centers, made employer contributions into the Pension Plan. *See* Exhibit 12 at page 3. However, because the Plan contained sufficient assets as of 1987 to meet all actuarially calculated future obligations, the University stopped making contributions to the Pension Plan in 1990-91.<sup>6</sup> *Id.*

The University of California's financial reporting is governed by GAAPs issued by the Government Accounting Standards Board ("GASB"). *See, e.g.,* Exhibit 13 (Summary of GAS

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<sup>6</sup> Between 1987 and 1991, the University continued to make contributions into the Pension Plan, although such contributions were not required to meet the actuarially determined liabilities of the Pension Plan. As of FY 2004, the Pension Plan remained adequately funded to meet all actuarially calculated future obligations.

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27). Under GAS 27, the University of California would only report pension costs related to contributions into the pension fund.

The postretirement benefits plan is not a defined benefit contribution plan. There is no trust fund; the University does not fund the postretirement benefits in advance based on actuarial projections, but rather it pays out each year the amounts required for that year's service costs.

Beginning in 1994, when the requirement for hospitals to submit data for an annual wage survey began, the UC Med Centers failed to report any of its pension costs on the wage survey. For postretirement benefits, the UC Med Centers claimed only the annual payments for current service costs.

At some point, the Med Centers realized that that they were incorrectly failing to report pension and postretirement benefit costs for wage index purposes, and therefore being disadvantaged, because the treatment of pension and postretirement benefits costs under the GASB rules differed from the treatment of such costs under financial reporting rules established for non-governmental entities by the Financial Accounting Standards Board ("FASB"). Specifically, FAS 87, relating to pension cost, requires employers to report an amount on their financial statements regardless of whether they are making current contributions to their pension plan. This amount results from a complex calculation that takes into account the following six items:

1. Service cost
2. Interest cost
3. Actual return on plan assets, if any
4. Amortization of unrecognized prior service cost, if any
5. Gain or loss (including the effects of changes in assumptions) to the extent recognized
6. Amortization of the unrecognized net obligation (and loss or cost) or unrecognized net asset (and gain) existing at the date of initial application of this Statement (paragraph 77).

FAS 87 (paragraph 20) (Exhibit 14).<sup>7</sup>

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<sup>7</sup> We have attached only excerpts of the 100 + page FAS 87 standard. The reader may review the entire FAS 87 by going to [www.fasb.org](http://www.fasb.org).

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The reporting of postretirement benefits is governed by FAS 106, which requires that employers report net periodic postretirement benefit cost, an amount that differs from current contributions, on their financial statements. Relevant excerpts of FAS 106 are attached as Exhibit 15.

As we understand it, both GASB and FASB establish GAAPs, but for different entities. GAAP for the reporting of pension and postretirement benefits costs differ between GASB and FASB.<sup>8</sup> In its 1994 Federal Register pronouncement regarding how to report wage-related costs for wage index purposes, CMS stated that GAAP should be followed, but did not recognize that there could be differing principles established under GASB as compared to FASB, both of which would be considered "GAAP."<sup>9</sup> Since the purpose of the wage index is to determine relative wage costs in different CBSAs, this purpose would unquestionably be undermined if the same methodologies were not used by all entities to report their costs.

The UC Med Centers brought this anomaly to the attention of the Intermediary and requested to use FASB reporting requirements to govern how they reported their pension and postretirement benefits costs for wage index purposes. The Intermediary ultimately agreed after consultation with CMS. Thus, from 2002 through 2004, the Med Centers used FASB rules to calculate the pension cost that would be reported on their Worksheets S-3, Part II. See Letter from Bejan S. Malbari, Manager, Provider Audit Department, UGS, dated January 28, 2004 and correspondence leading up to it, attached collectively as Exhibit 16. This Intermediary determination was not made without significant input from CMS. Note that Brett James at CMS was copied on the approval letter dated January 28, 2004. See Exhibit 16. Thus, the OIG Draft Reports are clearly erroneous to suggest that the UC Med Centers did not report their pension and postretirement costs properly and in accordance with Medicare guidance.

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<sup>8</sup> For instance, GAS 27 requires that pension expense should equal the required contributions. Exhibit 13. If the plan is overfunded, there are no required contributions or recorded pension expense. FAS 87 however recognizes pension costs using the above-referenced six cost components. Exhibit 14. Under this methodology, pension costs are more consistently reported due to the amortization of the prior year service costs and unrecognized net obligations, without regard to the employers approach in funding the plan.

<sup>9</sup> However, CMS's statement in the 1994 that wage related costs "recorded under GAAP tend to be more static from year to year" clearly indicates that CMS was focused on FASB and not the contribution-focused GASB. See Footnote 8 above; and 59 Fed. Reg. at 45357 (Exhibit 10).

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### **2004 Wage Survey and OIG Review**

We are attaching as exhibits all pertinent documents relating to the actuarial and accounting treatment of the pension and postretirement benefit costs for the five UC Med Centers. This will enable the reader to trace exactly how the Med Centers calculated the amounts for pension and postretirement benefit costs that they reported on the 2004 Wage Survey.<sup>10</sup> We are attaching the following documents:

Exhibit 12: Financial Report for The University of California Retirement System Retirement Plan for the Year Ended June 30, 2004, prepared by PricewaterhouseCoopers.

Exhibit 17: Actuarial Valuation Report as of July 1, 2004 for the University of California Retirement Plan, dated October 2004, prepared by The Segal Group, Inc. ("Segal Funding Report"). This report analyzes the assets and liabilities of the Retirement Plan (Pension Plan) and makes a recommendation about necessary contributions, in accordance with GASB principles. The Report determined that, though the funded ratio decreased from the previous year, the Plan is still in an overfunded position and no current contributions need be made.

Exhibit 18: Report re FAS 87 Expense for Fiscal Year Beginning July 1, 2003 for the University of California Retirement Plan, dated October 11, 2004, prepared by The Segal Group, Inc. This report calculates the costs associated with the Pension Plan for each of the five UC Med Centers, in accordance with FASB principles. This Report was prepared solely for the purpose of Medicare reporting, in accordance with the agreement reached between the Intermediary and the Med Centers.

Exhibit 19: Summary of Valuation Results for the Postretirement Welfare Plans of the University of California Medical Centers for the Fiscal Year Beginning July 1, 2003, dated November 2004, prepared by Deloitte Consulting LLP. This report was prepared in accordance with FASB principles for the purpose of Medicare reporting.

Exhibit 20: February 24, 2005 Report of Independent Accountants performed by Price Waterhouse Coopers, the University of California's financial auditors, indicating that the procedures performed by Segal for calculating the FAS 87 and FAS 106 expense were in accordance with FAS 87 and FAS 106 if the UC Medical Centers were required to report pension and post retirement costs as non-government facilities. This report was also prepared solely for the purpose of Medicare reporting, in accordance with the agreement reached between the Intermediary and the Med Centers.

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<sup>10</sup> As explained above, UCI made an error when reporting its costs, which needs to be corrected. See *infra* Section on UCI Adjustments.

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Exhibit 21: The as-filed Worksheets S-3, Part II and HCFA Form 339s that were submitted by all five UC Med Centers to report wage related costs for the 2004 Wage Survey; and the relevant pages from the UC Med Centers' general ledgers.

These documents show that the Med Centers submitted their wage data for 2004 following FASB principles, as agreed to by the Intermediary (and in a manner completely consistent with the applicable wage index instructions by CMS in the Federal Register and the applicable PRM-II cost report instructions).

In its preliminary findings and draft reports, the OIG alleges that the Med Centers should not have reported the amounts for pension and postretirement benefits that were reported in accordance with FASB principles. The UC Med Centers strongly disagree with these findings. The UC submitted a letter to the OIG audit manager summarizing some of the reasons why the UC Med Centers believe that the OIG's reasoning is incorrect. *See* Letter from Max M. Reynolds, University Counsel, to Jerry M. McGee, dated January 4, 2006, attached as Exhibit 22. The OIG Draft Reports do not appear to address any of the points made in this January 4, 2006 letter.

As stated above, UGS has simply used the OIG's preliminary findings to determine its audit adjustments to the Med Centers' 2004 wage data as part of its current review, without making an independent determination of the validity of these adjustments. Proposed adjustments were presented to UCSF, which submitted a written response to the UGS auditor disagreeing with the proposed adjustments. *See* Letter from Charlotte Canari to Anna Cheong, dated February 1, 2006, attached as Exhibit 23. Then, as noted above, the UC submitted a more comprehensive rebuttal to the proposed adjustments for all five campuses by letter dated March 10, 2006. *See* Exhibit 26. UGS declined to respond substantively to the March 10 submission, and is instead waiting for OIG and/or CMS instructions. *See* Exhibit 27.

#### **Why The Pension Cost Adjustments Should Be Reversed**

The OIG, in its draft findings, has come to the wrong conclusion about how pension costs should have been reported by the Med Centers on the 2004 Wage Survey. Further, the OIG's extremely brief discussion of the issue (*see, e.g.*, Exhibits 6, 7 and 8, at p. 4 of each) indicates that the OIG has only obtained a limited understanding of the issue and has ignored numerous important factors. The OIG admits that the "pension costs . . . were actuarially determined in accordance with GAAP." (The OIG makes no distinction between the GAAP rules under GASB as compared to under FASB, which, of course, is critical to understanding the issue.) The OIG does not seem to recognize that the 1994 Federal Register specifically informed providers to follow GAAP when reporting costs on the Wage Survey and that the Intermediary (and CMS) agreed that (1) it was appropriate for the Med Centers to follow FASB, rather than GASB, when reporting pension costs, and (2) that the pension costs as reported were consistent with FAS 87.



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At the time when the Med Centers filed their 2004 cost reports, they reported pension costs on the wage survey exactly as required by CMS at that time.<sup>11</sup>

We believe that the pronouncements in the Proposed and Final Inpatient PPS Rules for FY 2006 do not require the UC Med Centers to report pension costs on future wage surveys differently than they did on their FY 2002, 2003 and 2004 wage surveys. CMS made its concerns abundantly clear in the Federal Register discussions: they were concerned about unfunded plans that would never be funded. Exhibit 10. Presumably, this is also the OIG's concern, which CMS was reacting to in the May and August 2005 Federal Registers. See Exhibit 10. CMS wanted to make sure that the Medicare liquidation of liability principle would be applicable to the reporting of pension and postretirement costs, so that no cost could be claimed if a provider was not going to liquidate a liability:

When CMS issued the September 1, 1994 instructions, CMS did not anticipate nor intend for hospitals to include costs in the wage index that have not been funded and may never be funded. Including unfunded deferred compensation costs in the wage index can significantly misrepresent an area's average hourly wage, especially if the plan is never funded.

70 Fed. Reg. at 47369 (Exhibit 10). CMS's concern would apply in situations where a provider has a plan that is not a "qualified" pension plan or defined contribution deferred compensation plan (such as the Med Centers' Postretirement Welfare Plan, discussed below). For such plans, providers may only claim payments actually paid to a participating employee as an allowable cost (and only to the extent considered reasonable). See PRM-I, § 2140.2 (Exhibit 24). CMS's concern would also apply in situations where a provider has a qualified plan and has an accrued liability that has been actuarially determined as a required contribution into the plan, but does not liquidate this liability within one year, as required by the Medicare liquidation of liability rules.

Neither of these two scenarios applies to the UC Med Centers' Pension Plan. Regardless of the terminology used by the OIG in its draft reports, the Pension Plan is not an unfunded plan. See Exhibits 12 and 17. Instead, the UC Pension Plan is a funded plan that meets the requirements of PRM § 2142.3:

In order for a plan to be considered funded for purposes of Medicare cost reimbursement, the liability to be funded must have been determined, and the provider must be obligated to make

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<sup>11</sup> As discussed above, no discernible or authoritative modification or clarification of CMS's clearly expressed 1994 policy regarding the reporting of the pension costs can be found in the minor revision to Section 3605.2 of PRM-II that was made in 2003.

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payments into the fund. Funds existing at the discretion of the provider are not considered valid, and such plans are treated as direct pension plans. Payments are allowed only when paid to the beneficiary.

*See* Exhibit 24. Importantly, the Med Centers' Pension Plan is not a discretionary, direct pension plan (*see* Exhibits 12 and 17), so allowable costs are not limited to payments made to the beneficiaries of the plan.

Apparently, whatever questions have been raised by the OIG exist because the UC Med Centers' Pension Plan has been overfunded for many years, so current contributions by the employer have not been required. Under GAAP (i.e., FAS 87), employers do incur a cost, calculated from the six components set forth above, even though they are not actuarially required to make a current contribution. Exhibit 14. The situation of sufficiently funded pension plans is not addressed in the applicable PRM-I provisions, nor was it addressed by CMS in the Federal Register discussions in 2005.

Wage data reporting for qualified plans that are not underfunded should not be affected by the 2005 Federal register pronouncements. In accordance with the PRM-II instructions for completing the wage survey, which remain in effect, a hospital must use GAAP to determine wage-related costs for the wage index. Thus, it is clear that the cost calculated under FAS 87 is the correct cost to be placed on Worksheet S-3, Part II. It was correct in 2004 when the 2004 Wage Survey was completed, and it remains correct today even after CMS gave guidance in the Federal Register that requires application of Medicare principles, rather than purely GAAP, be followed in certain situations.<sup>12</sup>

Indeed, CMS's August 2005 Federal Register statements in no way indicate an intent to abandon GAAP in favor of the PRM nor do they in any way suggest that CMS's initial 1994 policy rationale for using GAAP is not applicable. That is, the FASB approach to pension costs will result in a more stable, static, and equitable nationwide reporting of pension costs for wage index purposes. For a fully funded plan, such as the University of California's, there is simply no rational basis for excluding the actuarially determined FAS 87 pension costs for wage reporting purposes. CMS's or OIG's concerns about non-funding or not liquidating a liability simply do not apply to a fully funded pension plan.

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<sup>12</sup> The UC Med Centers did, in fact, report their pension costs in accordance with FAS 87 as agreed to by CMS and UGS. *See* Exhibits 18, 21, and 25.

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**Any Change from the Use of FASB for Reporting Pension Costs is Improperly Retroactive**

Regardless of whether the 2005 Federal Register guidance would require a change in how the UC Med Centers report their pension cost in the future (which, as noted above, we do not think is the case), it would certainly be inappropriate for the OIG to recommend that the Med Centers retroactively alter the methodology for reporting pension costs that was correct at the time the 2004 Wage Survey was completed. This would essentially be akin to retroactive rulemaking which has been clearly prohibited by the United States Supreme Court. *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204 (1988). Further, such a retroactive change would be antithetical to CMS's own longstanding policy regarding wage survey data and the wage index. CMS specifically expressed this policy when making changes to the collection of wage data for wage index purposes in 1994:

In addition, it has always been our policy not to apply policy changes retroactively. The revisions to our policies regarding the reporting of wage-related costs represent a change in policy. The current policies are still in effect for the FY 1992 cost reports that will be used in computing the FY 1996 wage index. Since the prior cost reporting periods have already ended or are about to close for many providers, we do not believe it is appropriate to change the reporting rules retroactively. Further, it would not be fair to hospitals to require that they retroactively revise their recordkeeping systems to accommodate these changes.

Finally, while it is true that adjustments to the wage index will not be reflected until FY 1999, this allows time for hospitals that may be adversely affected to adjust their fiscal plan. The changes we are implementing on the reporting of wage data are extensive and will likely result in some payment shifts. We believe that it is incumbent upon us to allow hospitals sufficient time to adjust their operations so they can continue to provide efficient and quality services to all beneficiaries. Therefore, to ensure that hospitals have ample time to adjust for the changes in the reporting of wage data, all changes will be effective for cost reporting periods beginning on or after October 1, 1994, and thus are scheduled to be reflected in the wage index for FY 1999.

59 Fed. Reg. at 45359 (Exhibit 10).

We have quoted at length from the Federal Register, because CMS so persuasively explained why retroactively applying wage data reporting rules to construct a current wage index would be unwise and unfair. If the proposed adjustments to the Med Centers' pension costs (which are based solely on the OIG's recommendations) are allowed to stand, there will be a

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significant impact on the wage indices in the CBSAs where the five Med Centers are located, especially in the San Francisco and Sacramento CBSAs (both UCD and UCSF are the largest providers in their respective CBSAs). This will impact not only the five Med Centers, but all other hospitals located in the Med Centers' CBSAs. The hospitals will experience a significant decrease in Medicare reimbursement, without any lead time to adjust to new fiscal constraints. This will be especially difficult for hospitals in California, which are experiencing significant financial pressures due to the State's implementation of the nursing staff ratios and other regulatory requirements.

Further, because this change in reporting requirements must be applied retroactively by fiscal intermediaries around the country during this wage data review process, there is no guarantee that all hospitals will be treated the same. In fact, it is unlikely that the Intermediary would be making these adjustments if not for the fact that the OIG is in the process of doing its review. For other providers, with no OIG draft report to dictate adjustments, we believe that many fiscal intermediaries will not be implementing retroactive adjustments to pension costs in cases where such adjustments might be called for by CMS's new guidance.<sup>13</sup> This will result in unequal treatment for hospitals in different CBSAs, which will unfairly skew the relative wage indices in different parts of the country. For this reason alone, different rules should not be applied in the current wage data review than were in effect at the time that the 2004 Wage Survey was completed.

The OIG has failed to acknowledge CMS's August 2005 change in policy on the reporting of pension and postretirement benefit costs. This change in policy occurred nearly a year after the UC Med Centers filed their FYE 6/30/04 Medicare cost reports. Indeed, the OIG should not only have acknowledged the CMS change in policy, but the OIG should also be sensitive to (and avoid) making findings and recommendations regarding wage index data that would quite clearly result in inequitable, retroactive policies.

#### **Why the Postretirement Benefits Cost Adjustments Should Be Reversed**

The UC Med Centers agree that, under the new guidance issued by CMS in the recent Federal Registers, its treatment of postretirement benefits cost on future wage surveys will have to change. The Postretirement Welfare Plan is not a funded plan; contributions are not made in advance to create a fund to finance future liabilities. Payments are made each year by the

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<sup>13</sup> As stated above, we do not believe that the new guidance does, in fact, call for changes to the reporting methodology for the UC Med Centers' pension costs. It is unlikely that fiscal intermediaries reviewing other hospitals with qualified, but overfunded, pension plans are making similar adjustments. This is probably also true for situations where the new guidance does clearly call for a change in reporting of pension cost data, i.e., for providers with underfunded plans that did not liquidate accrued liabilities within the required one year.

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University (with the Med Centers paying their share) to fund current expenditures. The provisions of PRM-I, § 2140.2 are clear that, because this is an unfunded deferred compensation plan, payments may only be treated as allowable cost when actually paid to the participating employee.

This does not mean, however, that there is no cost under FASB reporting policies. To the contrary, FAS 106, which governs such plans, requires reporting of net periodic postretirement benefit cost and provides guidance on how to calculate this. *See* Exhibit 15. This is the calculation that UC Med Centers properly used when completing the 2004 Wage Survey, pursuant to CMS instructions to follow GAAP, rather than Medicare principles, when determining cost for wage index purposes and with the full approval of the Intermediary (and CMS). *See* Exhibits 19, 21, and 25. As with pension cost, this was ignored by the OIG in its draft reports.

Although the Med Centers must report only actual payments to beneficiaries as their cost for postretirement benefits on future wage surveys (as they did on the 2005 Wage Survey that was just recently completed), we believe that it is inappropriate for the OIG to recommend adjustments to wage data from a prior survey, for the same reasons set forth above in relation to the pension costs. In fact, whereas it is unclear exactly how common it is for providers to have overfunded pension plans or pension plans with liabilities for contributions that were not liquidated within one year, it is likely that a large number of providers will have to change the reporting of their postretirement benefits after the issuance of CMS's 2005 guidance. In fact, we understand that it is rare for an employer to fund postretirement health benefits in advance, so many plans that had reportable costs under FAS 106 will now have to report only their annual payments. As with the pension cost, we suspect that fiscal intermediaries that do not have the benefit of an OIG review will miss this adjustment, resulting in unequal treatment of these costs among hospitals around the country.

The OIG has failed to acknowledge CMS's August 2005 change in policy on the reporting of pension and postretirement benefit costs. This change in policy occurred nearly a year after the UC Med Centers filed their FYE 6/30/04 Medicare cost reports. Indeed, the OIG should not only have acknowledged the CMS change in policy, but the OIG should also be sensitive to (and avoid) making findings and recommendations regarding wage index data that would quite clearly result in inequitable, retroactive policies.

**Specific Pension/Postretirement Related Adjustment Issues for UCI**

As noted above, UCI incorrectly reported FY 2003 pension and postretirement benefit costs on the as-filed S-3, Parts II and III and Form 339. Exhibit 21. For the convenience of the reader, we have provided as Exhibit 25 a master reconciliation (for all the UC Medcenters) between the as-filed wage related costs, the actuarially determined pension and postretirement benefit costs, and the Intermediary's proposed adjustments (based on OIG draft recommendations to the Med Centers) to these costs. With respect to UCI, the proper FAS 87

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pension and FAS 106 postretirement benefit costs are not those reported by UCI on the as-filed cost report but instead are the FY 2004 costs as laid out in the Segal and Deloitte Reports. See Exhibit 18 at page 7 and Exhibit 19 at page 8; *see also* Exhibit 21.

**UCSF Response on Non-Pension/Non-Postretirement Benefit Issues**

UCSF sets forth in this section its response to the OIG's findings and recommendations on various wage data issues not related to pension or postretirement benefit costs.

1. Misclassified salaries and hours, which understated wage data by \$621,238 and 64,903 hours:

- |  |   |
|--|---|
| a. Misclassified Salaries Reported as Wage-Related Costs of \$3,660,622 and Hours of 51,322                        | Agree with finding/<br>Disagree with causes and recommendations |
| b. Patient Relation Costs of \$421,160 and related hours of 11,358 was misclassified and reported as Excluded Area | Agree with finding  |
| 2. Misstated Total Hours, which overstated Wages by \$145,059 and understated hours by 16,229                      | Disagree with finding   |
| 3. Understated Contract Labor Services, which understated wage data by \$4,232,807 and 63,664 hours                | Agree with finding/<br>Disagree with causes and recommendations |

**Reasons for Disagreements:**

1. Misclassified Salaries and Hours: This bullet point in the draft OIG report consists of two separate issues, as discussed under 1(a) and 1(b) below. The combined impact of 1(a) and 1(b), after consideration of excluded areas and overhead rates, results in the effective understatement of wage data by \$621,238 and 64,903 hours.

1a. Misclassified Salaries costs of \$3,660,622 reported as Wage Related Costs, and the associated understatement of 51,322 hours, before consideration of excluded areas and overhead rates:

UCSF agrees with this finding, as it is a correction presented to the OIG auditors by UCSF. However, UCSF disagrees with the OIG's explanation of the cause of the error.

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The OIG states that the “Medical Center did not sufficiently review and reconcile wage data to ensure that all amounts reported were accurate, supportable, and in compliance with Medicare regulations and guidance.” UCSF’s self-review and reconciliation process, in fact, led to the discovery of the error of reporting two general ledger accounts as Wage-Related Costs as opposed to Salaries in the As-filed Cost Report. The correction of this error was presented to the OIG auditors at the time of the entrance conference.

1b. Misclassification of Patient Relation Costs totaling \$421,160 and associated 11,358 hours by reporting them as Excluded Area wage data, before consideration of excluded areas and overhead rates:

UCSF agrees with this finding.

2. Misstated Total Hours, which effectively overstated wages by \$145,059 and understated hours by 16,229, after consideration of excluded area and overhead rates.

There are five components to this finding, before consideration of excluded area and overhead rates:

i. Pay in lieu of compensatory time off	28,115
ii. Overstatement of Compensatory time taken	(7,120)
iii. Overstatement of Compensatory time accrued	<u>(1,069)</u>
Subtotal Compensatory Time Related	19,927
iv. Extended Sick Leave Paid Hours	<u>8,928</u>
Addition to Total Paid Hours	<u>28,855</u>
v. Misclassification of excluded area hours	8,320

UCSF is in agreement with all of the components listed except for the proposed add-back of 28,115 hours associated with Pay In Lieu of Compensatory time off.

The 28,115 hours represent hours associated with Pay-in-lieu of time off. UCSF has a policy of allowing certain classes of employees to elect to be paid immediately for their overtime worked, or to “bank” their overtime in a compensatory time off bank, which would allow them to take time off at a later date. See Exhibit 28. If an employee elects to bank overtime, he or she may (1) take time off at a later date and reduce the balance in the compensatory time off bank, or (2) end up not taking time off for various reasons, resulting in an accumulated balance of compensatory time off. If the employee’s compensatory time balance reaches a certain limit, e.g. 120 hours, UCSF would reduce the employee’s balance to a pre-set level, e.g. 100 hours, by paying to the employee the 20 hours at his or her hourly rate. If the employee continues to leave 100 hours in the bank, UCSF would pay the

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outstanding balance of 100 hours at the employee's hourly rate in either late April or late October. The 120 hours in the above illustration is essentially the same type of hours as the above-listed 28,115 hours, which would be considered by UCSF as pay in lieu of the employee taking time off. According to PRM-II Section 3605 of the CMS Cost Reporting Instructions, pay-in-lieu of time off is defined under Bonus Pay and therefore no hours should be reported. Specifically, Section 3605.2, Instructions for Column 1 state that "Bonus pay includes award pay and vacation, holiday, and sick pay conversion (pay in lieu of time off)." Instructions for Column 4 further state "No hours are required for Bonus Pay." UCSF asserts that it is in compliance with CMS Instructions by not including the 28,115 hours in the wage data.

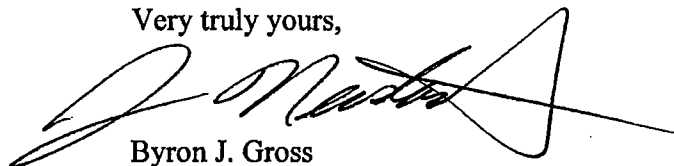
3. Understated Contract Labor Services by \$4,232,807 and 63,664 hours.

UCSF agrees with this finding, as it is a correction presented by UCSF to the OIG auditors. However, UCSF disagrees with the OIG's *general* assertion that UCSF "did not sufficiently review and reconcile wage data to ensure that all amounts reported were accurate, supportable, and in compliance with Medicare regulations and guidance." First, it is UCSF's policy to only report claimable costs as required by 42 C.F.R. Section 413.24(c). This section requires that "data be accurate and in sufficient detail to accomplish the purposes for which it is intended". At the time of the cost report deadline (November 30), UCSF did not have sufficient documentation or was not able to complete its analysis to report incremental contract labor costs and hours. However, as part of the annual Intermediary review, UCSF performs a follow up of outstanding issues from the initial cost report filing. To the extent additional data from outstanding issues can be documented and approved by the Intermediary, costs are added to the Wage Data. As part of the OIG review, UCSF performed a similar exercise and was able to locate all invoices to support the additional \$4,232,807 in direct patient care, non-nursing contract labor costs and the associated 63,644 hours.

**Conclusion**

For all the foregoing reasons, the UC Medical Centers request that the OIG reverse its pension and postretirement findings in their entirety. Further, UCSF requests that the OIG modify its finding on "misstated total hours" to clarify that CMS guidance would not permit the add-back of 28,115 hours associated with pay in lieu of compensatory time off.

Very truly yours,



Byron J. Gross

Jon P. Neustadter



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**Attachments**

cc: Max Reynolds, Esq. (w/o attachments) (Via U.S. Mail)  
Charlotte Canari (w/o attachments) (Via U.S. Mail)  
Bejan Malbari (w/o attachments) (Via Federal Express)  
Marty Lothes (w/o attachments) (Via Federal Express)  
Marc Hartstein (w/o attachments) (Via Federal Express)