DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date FEB 10 1992

From Richard P. Kusserow
Inspector General

Subject Report on the Independent Audit of Administrative Costs Incurred Under Parts A and B of the Health Insurance for the Aged and Disabled Program: Associated Insurance Companies, Inc. (A-05-92-00026)

To Gail R. Wilensky, Ph.D.
Administrator
Health Care Financing Administration

This memorandum alerts you to the issuance on February 12, 1992, of our final audit report. This report was prepared under an audit contract with the certified public accounting firm, Cotton and Company. A copy is attached.

Administrative costs incurred by Associated Insurance Companies, Inc. (Associated) for the period October 1, 1984 through September 30, 1986 under Parts A and B of the Health Insurance for the Aged and Disabled program contained amounts recommended for financial adjustment of approximately $2.5 million. Financial adjustments pertained to unallowable accrued pension costs of $1,145,136, inequitable and unsupported allocations and unallowable taxes of $892,859, unallowable contractor-owned automobile costs of $312,411, costs exceeding Notices of Budget Approval of $225,143, understated complementary credit adjustments of $155,644, overstated year-end adjustments of $110,541 and various other unallowable costs amounting to $158,789. Financial adjustments also included understated claims of $470,114 associated with allowable return on investment costs and recognition of net losses on the sale of depreciable property.

We are recommending that Associated make appropriate financial adjustments in these amounts. We are also recommending appropriate procedural improvements in relation to financial recommendations. The auditee concurred with financial adjustments amounting to approximately $277,771 and the procedural recommendations.

Regional Health Care Financing Administration officials generally concurred with the financial and procedural recommendations.

For further information contact:
Martin D. Stanton
Regional Inspector General
for Audit Services, Region V
FTS 353-2618

Attachment

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REPORT ON THE INDEPENDENT AUDIT OF ADMINISTRATIVE COSTS INCURRED UNDER PARTS A AND B OF THE HEALTH INSURANCE FOR THE AGED AND DISABLED PROGRAM

ASSOCIATED INSURANCE COMPANIES, INC.

Richard P. Kusserow
INSPECTOR GENERAL

A-05-92-00026

REPORT ON THE INDEPENDENT AUDIT OF
ADMINISTRATIVE COSTS INCURRED UNDER
PARTS **A AND** B OF THE
HEALTH INSURANCE FOR THE
AGED AND DISABLED PROGRAM

FOR THE PERIOD
OCTOBER 1, 1984, **THROUGH** SEPTEMBER **30,** 1986

ASSOCIATED INSURANCE COMPANIES, INC.
INDIANAPOLIS, INDIANA

The designation of financial and/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 Cotton **&** Company. Final determination on these matters will be made by authorized Department of Health and Human Services' officials.

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

OFFICE OF INSPECTOR GENERAL

Our Reference: Common Identification Number A-05-92-00026

February 12, 1992

Mr. Ronald Rosenberg
Executive Vice President Government Sector
8320 Craig Street, Suite 100
Indianapolis, Indiana 50451

Dear Mr. Rosenberg:

Enclosed for your information and use are two copies of an Office of Inspector General audit report titled "Report on the Independent Audit of Administrative Costs Incurred Under Parts A and B of the Health Insurance for the Aged and Disabled Programs for the period October 1, 1984 through September 30, 1986. The report was prepared under audit contract with the CPA firm, Cotton and Company and its subcontractor Sheffield, Behan and Company. Your attention is invited to the audit findings and recommendations contained in the report.

Final determinations as to actions to be taken on all matters reported will be made by the HHS official named below. The HHS action official will contact you to resolve the issues in this audit report. Any additional comments or information that you believe may have a bearing on the resolution of this audit may be presented at that time.

In accordance with the principles of the Freedom of Information Action (Public Law 90-23), Office of Inspector General reports issued to the Department's grantees or 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 referenced common identification number in all correspondence relating to this report.

Sincerely,

Martin D. Stanton

Martin D. Stanton
Regional Inspector General
for Audit Services

Enclosures:

Direct reply to:

Judith Stec
Associate Regional Administrator
Division of Medicare

This report is made pursuant to Contract HHS-100-87-0017. The approved contract amount with the Department of Health and Human Services as of November 30, 1991, is $239,779. Total audit costs incurred from inception of the contract through November 30, 1991, are approximately $239,779. This amount includes the cost of audits of Health Care Service Corporation, Blue Cross and Blue Shield Association, and Associated Insurance Companies, Inc.

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

David L. Cotton, CPA
Brenda N. Burzenski, CPA
Catherine L. Nocera, CPA
Roger Sheffield, CPA

SUMMARY

Blue Cross and Blue Shield Association (BCBSA) entered into an agreement with the Secretary of the Department of Health and Human Services (DHHS) to participate as a Medicare intermediary in administering the Medicare program. Under a subcontract with BCBSA, Associated Insurance Companies, Inc. (the Contractor), receives, reviews, audits, and pays Medicare A claims. In addition, under an agreement with DHHS, the Contractor participates as a Medicare carrier in administering the Medicare B program. The Contractor is reimbursed for all reasonable and allowable costs that are not specifically limited by the Medicare agreements. Allowable costs are determined in accordance with Federal Acquisition Regulation (FAR) Part 31, as interpreted and modified by Appendix B to the Medicare agreements.

We made our examination in accordance with generally accepted auditing standards and the ***Standards for Audit of Governmental Organizations, Programs, Activities and Functions*** (General Accounting Office, 1981), published by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance that the final administrative cost proposals (FACP) are free of material misstatement. Our audit also included an evaluation of the accounting system and related internal controls, and the application of the auditing procedures contained in DHHS Interim Audit Instruction, E-l revised, Part One, dated May 1981.

The period covered by the examination was October 1, 1984, to September 30, 1986. During this period, the Contractor claimed $14,713,520 (Part A) and $25,900,681 (Part B) for administering the Medicare programs. We recommend that the Contractor adjust its FACPs by $1,237,920 (Part A) and $1,292,489 (Part B) to eliminate unallowable and unallocable costs charged to the Medicare programs. The major audit findings are briefly discussed below. A more detailed explanation of each finding appears in the Findings and Recommendations section of this audit report.

- The Contractor claimed $1,145,136 of unallowable accrued pension costs that were not required to be expensed. The Contractor did not concur with this finding.

- The Contractor claimed $773,459 of unallowable costs that were allocated based on inequitable and unsupported allocation methods. The Contractor concurred with only part of this finding.

- The Contractor did not claim allowable return on investment (ROI) costs totaling $(465,009) because of errors and estimates used in computing its ROI costs. The Contractor concurred with this finding.

- The Contractor claimed $312,411 of unallowable Contractor-owned automobile costs that were for personal use or exceeded the Federal Travel Regulation reimbursement rate. The Contractor concurred with only part of this finding.

- The Contractor claimed $225,143 exceeding its approved Notices of Budget Approval. The Contractor did not concur with this finding.

- The Contractor understated its complementary insurance program credits because of computational errors and methodology errors in computing the credits. Unallowable costs total $155,644. The Contractor concurred with only part of this finding.

- The Contractor claimed $119,400 of unallowable taxes that were either allocated based on estimated costs or were not allocable to the Medicare program. The Contractor concurred with this finding.

- The Contractor claimed $110,541 of unallowable costs because of errors in computing and reversing its FACP fiscal year-end adjustments. The Contractor concurred with only part of this finding.

- The Contractor claimed $61,778 of unallowable advertising and promotional costs. The Contractor concurred with only part of this finding.

- The Contractor claimed $60,774 of unallowable professional and consulting costs that benefitted its affiliates and its non-Medicare business. The Contractor concurred with only part of this finding.

- The Contractor did not claim $(5,105) of allowable costs, because it did not charge the Medicare program for its net losses on the sale of depreciable property. The Contractor did not concur with the draft report finding, which was revised for the final report.

- The Contractor claimed $25,820 of unallowable costs related to travel and entertainment, Blue Cross Association dues and wire system costs, settlement expenses, financial costs, relocation expenses, and contributions. The Contractor concurred with only part of this finding.

- The Contractor claimed $10,417 of unallowable state insurance commissioner audit costs that did not benefit the Medicare agreement. The Contractor did ***not concur*** with this finding.

- The Contractor claimed Indiana gross income taxes (IGIT) based on gross Medicare receipts. Because the findings in this report will reduce the fiscal year gross receipts the IGIT should be reduced accordingly. We did not compute a recommended adjustment because it should be based on the amount of sustained findings. The Contractor did not respond to this finding.

These costs are unallowable in accordance with FAR Part 31 and the terms and conditions of the Medicare agreements.

As described in the Other Matters section of this report, the Contractor prepaid ***costs*** at the end of Fiscal Year (FY) 1983 and claimed them on its **FY** 1983 FACP. These costs were not incurred until **FYs** 1984 and 1985 resulting in out-of-period costs, which are unallowable in accordance with FAR **31.201-2**. The Contractor did not respond to this issue.

We evaluated the Contractor's system of significant internal accounting and administrative controls, and compliance with laws and regulations that can materially affect the Contractor's **FACPs**. Based on our study of the significant control elements required by DHHS, we believe that the Contractor's procedures for segregating unallowable and **unallocable** costs were not adequate for DHHS purposes because of the conditions described above, which we believe are material weaknesses in relation to the agreements to which this report refers. Cur review on compliance disclosed that except for certain material instances of noncompliance with FAR Part 31 and the Medicare agreements, the Contractor complied with the terms and provisions of laws and regulations for the transactions tested. Cotton **&** Company's reports on internal control and compliance and its opinion on the **FACPs** appear later in this report.

CONTENTS

INTRODUCTION

BACKGROUND

Health Insurance for the Aged and Disabled (Medicare), Title XVIII of the Social Security Act, as amended, is a broad program of health insurance that became effective in July 1966. For certain disabled individuals and individuals aged 65 or over, Title XVIII, Part A, provides a basic insurance plan covering hospital costs and related care. For these same individuals, Title XVIII, Part B, provides a voluntary insurance plan covering physician costs and other health services.

The Health Care Financing Administration (HCFA) administers the Medicare program. Under an agreement with the Secretary of the Department of Health and Human Services (DHHS), 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. (the Contractor), receives, reviews, audits, and pays Medicare A claims. In addition, the Contractor has an agreement with DHHS to participate as a Medicare carrier; under this agreement, it receives, reviews, audits, and pays Medicare B claims. Subject to limitations specified in the agreements, the Contractor is entitled to reimbursement for allowable administrative costs incurred.

Fiscal Year (FY) 1985 Medicare agreements did not contain any cost reimbursement limitations. FY 1986 Medicare agreements contain unit-cost target rates for each bill (Part A) and claim (Part B) processed for the following FACP operations:

- Part A
  Bills Payment
  Reconsideration and Hearings

- Part B
  Claims Payment
  Reviews and Hearings
  Beneficiary/Physician Inquiry

The Contractor is entitled to reimbursement for its actual allowable costs incurred for these operations. Reimbursement exceeding the target rates in FYs 1986 and 1987, however, would reduce the FY 1988 unit target rates. These FY 1988 unit target rates would be the maximum allowable rates for FY 1988. The Contractor chose not to claim its costs exceeding the target rates for FY 1986, which were $2 per bill (Part A) and $1.78 per claim (Part B) processed.

From October 1, 1984, through September 30, 1986, the Contractor processed 12,902,473 Medicare claims for services amounting to $2,845,790,125. During this period, the Contractor claimed $40,614,201 for administering Parts A and B of the Medicare program.

Costs incurred in connection with Contractor activities are accumulated in cost centers and subsequently allocated to various lines of business, including Medicare.

REGULATIONS RELATING TO COST REIMBURSEMENT

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

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

FAR 31.202 and 31.203 define direct and indirect costs as follows:

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

SCOPE OF AUDIT

We audited the Contractor's final administrative cost proposals (FACP) from October 1, 1984, to September 30, 1986. The FACPs are the responsibility of Contractor management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and with the ***Standards for Audits of Government Organizations, Programs, Activities and Functions*** (General Accounting Office 1981), published by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance that the FACPs are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the FACPs. It also includes assessing the accounting principles used and significant estimates made by management and evaluating the overall FACP presentation. Our audit also included an evaluation of the accounting system and related internal controls, and the application of the auditing procedures contained in DHHS Interim Audit Instruction, E-l revised, Part One, dated May 1981. We believe that our audit provides a reasonable basis for our opinion.

The Contractor prepared the FACPs to present allowable costs incurred under the Medicare agreements in accordance with FAR Part 31 and the terms and conditions of the agreements; these FACPs are not intended to be a complete presentation of the Contractor's revenues and expenses.

The period covered by the examination was October 1, 1984, to September 30, 1986. Audit fieldwork was conducted at Associated Insurance Companies, Inc., Indianapolis, Indiana. We completed our onsite review on April 24, 1990.

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

FINDINGS AND RECOMMENDATIONS

PENSION COSTS -- --

The Contractor claimed $1,145,136 of unallowable pension costs for FYs 1985 and 1986, as explained below.

The Contractor accrued estimated pension costs of $4,550,997 in FY 1985 and $4,202,102 in FY 1986. Of these amounts, the Contractor funded $775,199 and $1,036,658, respectively. Because of the application of the Full Funding Limitation, the minimum required cash contribution was zero in both 1985 and 1986. In addition, the normal costs and the unfunded actuarial liability were zero for these years. Therefore, the Contractor did not have any pension expense for 1985 and 1986.

The Contractor, however, claimed both the accrued and funded pension costs allocated to Medicare totaling $623,883 in FY 1985 and $531,109 in FY 1986. These costs are unallowable in accordance with FAR 31.205-6(j)(2), which states:

> ...The cost of all defined benefit pension plans shall be measured, allocated, and accounted for in compliance with the provisions of 30.412, Composition and Measurement of Pension Costs, and 30.413, Adjustment and Allocation of Pension Cost.

The Code of Federal Regulations, Title 4, Chapter III, Part 412.40, states:

> For defined-benefit pension plans, the components of pension cost for a cost accounting period are (i) the normal cost of the period (ii) a part of any unfunded actuarial liability, (iii) an interest equivalent on the unamortized portion of any unfunded actuarial liability, and (iv) an adjustment for any actuarial gains or losses.

Finally, FAR 31.205-6(j)(3)(ii) states:

> Any amount paid or funded before the time it becomes assignable and allowable shall be applied to future years, in order of time, as if actually paid and deductible in those years....

In addition, FY 1985 costs claimed included $2,457 of unallowable pension costs caused by the Contractor's delay in funding its 1984 pension contribution. The final 1984 pension payment was not made until September 1985. These costs are unallowable in accordance with FAR 31.205-6(j)(3) (iii), which states:

> Increased pension costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable.

We reduced total unallowable pension costs by $741 in FY 1985 and $9,115 in FY 1986 for pension costs charged to the cost centers that were disallowed in the Unallocable Costs finding discussed below. We also revised the draft report audit finding by deleting $23,311 and $1,143 of FY 1986, Part A, Arkansas system implementation pension costs that were not claimed.

Recommendation

We recommend that the Contractor make the following adjustments to its FACPs:

	Part A	Part B
Costs not associated with an operation		
FY 1985	$279,019	$344,123
FY 1986	235,651	286,343

In addition, we recommend that the Contractor strengthen its internal control procedures for determining the allowability of pension costs.

Contractor Response

The Contractor concurred with this finding except for the computation of its dollar amount. It did agree that pension cost funding was not necessary in either fiscal year due to a change in its actuarial methodology. This, however, was not known until after the FACPs were submitted. The Contractor disagreed with the dollar amount, because it included Arkansas system implementation expenses (Recipient Code 050220) that were not funded because of budget restrictions.

Auditors* Additional Comments

We reviewed the finding computation and determined that it did include Recipient Code 050220 expenses. These expenses were claimed in FY 1985 but not in FY 1986. Because-our opinion is based on costs claimed, the finding remains the same for FY 1985. Because Recipient Code 050220 expenses were not claimed in FY 1986, we revised the finding to delete unallowable pension costs of $23,311 and $1,143 charged to this recipient code. These amounts differ from the Contractor-recommended reduction, because when we computed the draft report finding, we excluded a percentage that was related to allowable deferred compensation and actuary fees. The $23,311 and $1,143 are net of this exclusion.

UNALLOCABLE COSTS

The Contractor claimed $773,459 that is not allocable to Medicare for the reasons discussed below.

a. The Contractor claimed costs charged to seven cost centers related to its non-Medicare business that did not benefit the Medicare agreements. These are:

- 24536: Executive Loaned. This cost center was established to accumulate costs related to the Pan American games and is not allocable to Medicare. Unallowable costs totaled $3,572 in FY 1986.
- 30001: EVP Pool. This cost center included professional and consulting costs related to non-Medicare projects, executive search fees allocable to a Contractor subsidiary, and unallowable printing and stationery costs. Unallowable costs totaled $436,856 in FY 1986.
- 30500: Healthcare Operations Support. This cost center was established as the administrative cost center for the health care operation support unit that is not allocable to Medicare. Unallowable costs totaled $5,644 in FY 1986.
- 31460: National. The Contractor did not provide any documentation supporting this cost center. From its title, however, we determined that it is not allocable to Medicare. Unallowable costs totaled $3,500 in FY 1986.
- 31470: Affiliates/IA. The Contractor did not provide any documentation supporting this cost center. From its title, however, we determined that it is not allocable to Medicare. Unallowable costs totaled $19 in FY 1986.
- 31480: Consumer. The Contractor did not provide any documentation supporting this cost center. From its title, however, we determined that it is not allocable to Medicare. Unallowable costs totaled $1,340 in FY 1986.

- 33300: Consumer Division Marketing. This cost center does not benefit the Medicare program. Unallowable costs totaled $2,299 in FY 1985 and $21 in FY 1986.

These costs are unallowable in accordance with the Medicare agreements, Appendixes B, Section XV, which states:

> The following costs are unallowable:...All direct and indirect costs which relate to the Contractor's non-Medicare business and do not contribute to the Medicare agreement/contract.

b. The Contractor claimed costs charged to three cost centers that were not equitably allocated to all of the segments that benefitted from the costs. We reallocated these cost centers based on an allocation to the Contractor's five markets and the investment segment. Unallowable costs follow:

	FY 1985	FY 1986
10002: Board of Directors		$4,326
10003: Executive Assistant-Office of the Presidents	$ 2,239	
26111: Accounting	9.065	3.666
Total	$11.304	9 9 2

These costs are unallowable in accordance with FAR 31.201-4, which states:

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

c. The Contractor claimed costs charged to three cost centers that were allocated using inappropriate information, because budget or a prior year's statistics were used. This resulted in an inequitable allocation of costs to the Medicare agreements. We recomputed Medicare's costs using actual statistics and determined unallowable costs as follows:

	FY 1985	FY 1986
31340: Forms/Graphics		$33,836
31345: Records Center		28,737
24220: Risk Management	S26.776.	8 0 9
Total	S6.676	$90.382

These costs are unallowable in accordance with FAR 31.203(e), which states:

> A base period for allocating indirect costs is the cost accounting period during which such costs are incurred and accumulated for distribution to work performed in that period....

d. The Contractor claimed costs charged to three cost centers whose allocation bases were not supported. Based on our review of the nature of these costs and the cost center functions, we determined that the corporate dollar ratio was an acceptable allocation basis for measuring the reasonableness of the actual bases used by the Contractor. We recomputed Medicare's costs using this basis and determined unallowable costs as follows:

	FY 1985	FY 1986
23000: Corporate Affairs Administration	$4,068	$18,719
30100: Strategic Planning		30,570
30110: Planning and Information Office	350	3.677
Total	$45412 .	9 6 6

e. The Contractor claimed costs charged to two cost centers whose allocation bases were not supported. In addition, the cost center functions were not related to Medicare. Accordingly, we determined unallowable costs as follows:

	FY 1985	FY 1986
23100: Public Relations		$23,856
31530: New Products	$(2)	18.865
Total	$(2)	$42.721

These costs are unallowable in accordance with the Medicare agreements, Appendixes B, Section XV.

f. The Contractor claimed costs charged to Cost Center 22000: Legal Department, whose allocation basis was not supported. The Contractor represented that the costs were allocated based on each employee's monthly estimate of time allocable to each market. The documentation provided, however, did not support the allocation percentages actually used for the sample month tested.

We also reviewed the memorandums retained by the law department that document each attorney's case workload for the month. While these memorandums indicated that some work was indirectly allocable to Medicare, they did not provide the amount of time spent on each case.

We could not determine an equitable Medicare allocation for this cost center, because adequate documentation and information was not available. Therefore, we determined this total cost center to be unallowable in accordance with FAR 31.201-4. Unallowable costs total $46,248 in FY 1985 and $57,503 in FY 1986.

Recommendation

We recommend that the Contractor make the following adjustments to its **FACPs**:

	Part A	Part B
Costs not associated with an operation		
FY 1985	$ 30,952	$ 39,991
FY 1986	359,533	342,983

In addition, we recommend that the Contractor strengthen its internal control procedures for determining the allocability of costs.

Contractor **Response**

The Contractor concurred with only part of this finding. It agreed with the adjustments related to Cost Centers 30500, 31460, 31470, 31480, 10002, 26111, and 24220, but did not agree with the adjustments for the remaining cost centers. Its responses follow:

24536: Executive Loaned. The Contractor did not concur with this adjustment. It stated that this cost center's costs were for an employee who was loaned to the Pan American Games organizing committee. These costs, which represent a community service, are reasonably allocable to Medicare and, therefore, allowable in accordance with FAR 31.201-1(e)(3).

30001: EVP Pool. The Contractor concurred that this cost center was not allocable to Medicare; however, it did not concur with the adjustment amount. It stated that the adjustment did not take into account correcting entries made during October through December 1986 that removed unallocable Claim Pro system implementation costs and served to reduce FY 1987 Medicare expenses. It stated that, because these corrections applied to expenses incurred before September 30, 1986, they should reduce the FY 1986 finding.

33300: Consumer Division Marketing. The Contractor concurred with this adjustment except for $4, which it deducted as a Part A, FY 1986, FACP manual adjustment.

10003: Executive Assistant to B.S. President. The Contractor did not concur with this adjustment. It stated that it allocated 10 percent to Medicare Part B based on an estimate of specific duties performed. If the recommended "Equal to Markets" approach stands, a corresponding share of the costs should be allocated to Medicare Part A.

On March 18, 1991, the Contractor provided additional comments related to Cost Center 10003. It stated that although the correct title is Executive Assistant--Office of the Presidents, this cost center served the Blue Shield executive. It also was allocated using the equal-to-five market basis rather than an estimate of specific duties performed. Because the cost center reported to the Blue Shield executive, no allocation was made to Medicare, Part A. It further stated that because this cost center was not involved with investments, the five-market approach is reasonable. See Appendix B.

31345: Record Center. The Contractor agreed that the Medicare allocation percentages were not properly revised, when the Records Center and Forms/Graphics cost center was segregated into Cost Centers 31345 and 31340, effective January 1, 1986. It did not concur, however, with the adjustment amount. The Contractor recommended that we revise the finding amount based on the additional information included in its response.

31340: Forms and Graphics. The Contractor concurred that the Medicare allocation percentages were not properly revised for a cost center change, effective January 1, 1986. It did not concur, however, with the adjustment amount. The Contractor recommended that we revise the finding amount based on the additional information included in its response.

31530: New Products. The Contractor stated that this cost center is responsible for system implementation and enhancements, and that costs were allocated to the Part A Arkansas system implementation recipient code through February 1986. It further stated that $17,731 of this adjustment incurred in March, April, and May 1986 appears to be for Part A Arkansas system implementation followup and problem solving, and should be allowed.

23100: Public Relations. The Contractor stated that, beginning in January, 1986, the advertising costs that previously were included in this cost center were segregated into Cost Center 23150: Advertising, which was not allocated to Medicare. In January 1986, it began allocating the public relation costs to Medicare. It stated that, although the cost center does have a lobbying function, other functions that are allowable include responding to Congressional inquiries regarding claim matters, providing Medicare training and education to Congressional office staff, responding to news media regarding Medicare program changes, accumulating management information on the direction of the Medicare program, and communicating Medicare matters to Governmental agencies and congressional delegations. Therefore, its 11.32-percent allocation to Medicare is justified and reasonable. In addition, the Contractor stated that this cost center should have been allocated to Medicare from October 1984 through December 1985, and stated that the 1986 allocation method is reasonable for this period also.

30110: Performance Improvement Office. The Contractor concurred with the recommended change to the corporate dollar ratio allocation but stated that the Medicare Part A ratios used to compute the adjustment amount seemed low. In addition, it stated that if the revised method is used, the Medicare Part B costs should also be adjusted.

30100: Strategic Planning. The Contractor stated that an allocation method based on this cost center's two reporting cost centers appears reasonable, in general, but does not address the special project managers housed in Cost Center 30100. The Contractor stated that the Arkansas Medicare A system project leader was in Cost Center 30100. The project manager allocation should have been made to the Arkansas system implementation recipient code through February 1986, but follow-up work after March 1, 1986, when the system was implemented, is chargeable to the Part A recipient code. Accordingly, the finding should be reduced by $19,443.

The Contractor also contends that if the allocation basis is changed to the accumulation of Cost Centers 30110 and 30120, positive as well as negative adjustments should be made. Accordingly, the FY 1985 costs should increase by $5,998 and the FY 1986 allocation by $2,175.

23000: Corporate Affairs. The Contractor stated that it thinks the administrative functions performed in this cost center support its original allocation percentages. If the revised allocation approach remains in effect, however, it must be recalculated to incorporate any changes made to Cost Centers 23100, 30100, and 30110 as a result of its comments above.

22000: Legal. The Contractor stated that, historically, the legal department has not used standard allocation percentages; it used percentages that were adjusted monthly based on actual work performed. It also stated that it provided August 1986 input documents for each lawyer with a note that additional support was available in the "CHRON FILES" in the legal Division. The

Contractor indicated that these files were not reviewed during audit fieldwork.

The Contractor also stated that it reviewed the audit workpapers and noted that the Medicare allocation for one lawyer was incorrectly carried forward to the summary schedule. The Contractor revised the summary schedule and noted that the revised average came closer to the actual allocation percentage used for August. The Contractor stated that it thinks that the documentation originally provided supports the Medicare allocation, and this finding should be passed.

Auditors' Additional Comments

Additional comments for those adjustments that the Contractor did not concur with follow:

24536: Executive Loaned. The Pan American Games is an amateur sports contest between American nations that occurs every four years. It was hosted in Indianapolis, Indiana, in 1986, and the Contractor was a sponsor for the event. This event does not fit in the category of allowable community service activities, such as blood bank drives, charity drives, savings bond drives, and disaster assistance in accordance with FAR 31.205-1(e)(3). The Contractor's participation on the Pan American Games' organizing committee, is more clearly an unallowable public relations activity; the special event's purpose is other than dissemination of technical information or stimulation of production. These costs remain unallowable.

30001: EVP Pool. The FY 1986 finding should not be reduced to account for the October through December 1986 correcting entries, because the correcting entries did not reduce the FY 1986 FACPs. Our opinion is based on the FY 1986 claimed costs, which include the unallowable Claim Pro system implementation costs. Further, the Contractor suggested a finding reduction equal to the Cost Center 30001's net credit amount for October through December 1986, rather than Medicare's portion of only the system implementation cost correcting entries. This net credit is understated, because it includes entries related to FY 1987 incurred costs, as well as the correcting credit entries related to FY 1986 incurred costs. Because this entire cost center is unallocable, Medicare's total allocated amount, whether a net debit or credit, should be disallowed in both FYs 1986 and 1987.

33300: Consumer Division Marketing. We agree that the $4 was not claimed in FY 1986 and revised the final report accordingly.

10003: Executive Assistant--Office of the Presidents. Because Cost Center 10003 served Cost Center 10000: Blue Shield Executive, it should be allocated in the same manner as Cost Center 10000. Cost Center 10000 was allocated to the five markets and the investment segment; accordingly, Cost Center 10003 should be also. The finding remains unchanged.

31345: Records Center. We reviewed the Contractor's additional information and noted that it mistakenly recommended using the cost allocation input document for forms/graphics. We computed the draft report finding using the cost allocation input document specifically for the records center. The finding remains unchanged.

31340: Forms/Graphics. The Contractor mistakenly thought that the cost allocation input document for forms/graphics was for the records center and that a forms/graphics input document did not exist. Therefore, it computed Medicare allocation percentages using limited available information, some of which was not applicable to the allocation base period. We used the forms/graphics cost allocation input document to support a reasonable Medicare allocation, because more reliable information did not exist. Accordingly, the finding remains unchanged.

31530: New Products. The Contractor did not provide documentation to support this cost center's allocation percentages in any month, including March, April and May 1986. If March, April, and May costs were related to the Part A Arkansas system, they were not properly charged to the Arkansas system recipient code. In addition, the FY 1986 Arkansas system implementation costs were not approved by HCFA and are therefore unallowable. This finding remains unchanged.

23100: Public Relations. This cost center remains unallowable. The Medicare-related activities described in the Contractor's response were not included in the cost center profile, and the Contractor did not provide documentation to support the occurrence of these activities or their volume in relation to other non-Medicare cost center activities, including unallowable lobbying. Accordingly, the Contractor did not support the reasonableness of an equal-to-five market allocation method. In addition, the Contractor did not segregate unallowable lobbying costs before allocating this cost center to Medicare, in accordance with FAR 31.205-22(c).

An allocation of FY 1985 costs is not warranted because, before January 1986, unallowable advertising costs were included in Cost Center 23100. In addition, the equity of the FY 1986 allocation method was not supported and unallowable lobbying costs were not segregated before allocating the costs to Medicare, as described above.

30110: Planninn and Information Office. The Contractor did not provide any documentation to support this cost center's allocation basis. We do not recommend that the Contractor change its allocation method. Rather than disallowing the entire Medicare amount, we reviewed the cost center functions and determined that the corporate dollar ratio provided an acceptable basis for measuring the reasonableness of the actual allocation basis used by the Contractor. Accordingly, we disallowed the costs exceeding those that would have been allocated using the corporate dollar ratio, but we did not recommend increased costs.

The Contractor did not provide its computation of the Medicare Part A corporate dollar ratio. We reviewed our computation and found it accurate. This finding remains unchanged.

30100: Strategic Planning. This finding remains unchanged. We did not recommend using the combined Cost Center 30110 and 30120 allocation method as the Contractor's response indicates. In addition, we do not recommend that the Contractor-change its allocation method. Because the Contractor did not provide any documentation to support Cost Center 30100's allocation basis, we used the corporate-dollar ratio to measure the reasonableness of the actual allocation basis that the Contractor used. We therefore disallowed the costs exceeding those based on the corporate-dollar ratio, but we did not recommend increased costs.

Because the cost allocation method was not supported, we could not determine if the March through September 1986 Medicare A costs, including the project manager's costs, were equitably allocated. Accordingly, we used the corporate-dollar ratio to determine reasonableness.

23000: Corporate Affairs Administration. The Contractor did not provide any documentation to support its actual allocation basis for this cost center. We did not recommend that the Contractor change its allocation methodology to the corporate-dollar ratio; we used this method to measure the reasonableness of the actual allocation basis used by the Contractor. Accordingly, this finding remains the same.

22000: **Legal Department**. The Contractor did not provide supporting documentation for the allocation percentages used for this cost center. The Contractor provided cost allocation input documents for each attorney for the sample month of August 1986. We agree that the Medicare allocation for one attorney was erroneously recorded on our summary workpaper. We recalculated the Medicare percentages using the correct allocation for this attorney. The revised Medicare percentages, however, still do not tie to the Medicare percentages actually used for August 1986. In addition, the Contractor did not maintain timesheets to support the percentages on its cost allocation input documents. The Contractor indicated that additional support was available in "CHRON FILES". As discussed in the draft audit report, we reviewed these "CHRON FILES" during fieldwork. While these documents outline each attorney's monthly case workload, they do not include the amount of time spent on each case. This cost center's allocation basis was not adequately supported, and this finding remains unchanged.

RETURN ON INVESTMENT COSTS

The Contractor understated its allowable return on investment (ROI) costs by $85,900 in FY 1985 and $379,109 in FY 1986, because it used estimates and made errors in computing ROI costs claimed.

The Contractor erroneously calculated its ROI costs for equipment using asset net book values that were reported in a fixed asset system that had not been in use since 1984. The Contractor recomputed its equipment ROI costs using information from its current fixed asset system. Based on our review of the revised ROI costs, we determined that the Contractor had understated its equipment ROI costs claimed by $85,900 in FY 1985 and $181,060 in FY 1986.

The Contractor claimed FY 1986 ROI costs for its building based on an unsupported estimate. The Contractor recomputed its building ROI costs using actual cost data. Based on our review of the revised building ROI costs, we determined that the Contractor had understated cost claimed by $198,049.

These costs are allowable in accordance with the Medicare agreement, Appendixes B, Section X, which states:

> To the extent that land and tangible depreciable assets, such as buildings, equipment and leasehold improvements, owned by 'the contractor are used for Medicare purposes, the cost of investment will be determined by multiplying the average undepreciated balance of such assets for the contract period by the actual rate of return of the contractor's investment portfolio for the contract period, or a lower rate if the contractor so chooses.

Recommendation

We recommend that the Contractor make the following adjustments to its **FACPs**:

	Part A	Part B
Costs not associated with an operation		
FY 1985	$ **(50,990)**	**$ (34,910)**
FY 1986	(214,840)	(164,269)

In addition, we recommend that the Contractor strengthen its internal control procedures for determining the allowability of ROI costs.

Contractor Response

The Contractor concurred with this finding.

CONTRACTOR-OWNED AUTOMOBILE COSTS

The Contractor-claimed $109,048 in FY 1985 and $203,363 in FY 1986 of unallowable Contractor-owned automobile costs. These costs are unallowable for the following reasons.

The Contractor claimed $50,118 in FY 1985 and $74,536 in FY 1986 for the personal use of Contractor-owned automobiles. Although the Contractor established a policy to charge its employees for the personal use of the automobiles, and the amounts allocated to Medicare were net of these personal use charges, they were not sufficient to remove all of the automobile costs allocable to personal use. These costs are unallowable in accordance with FAR 31.205-46(a), which states:

> Costs for transportation, lodging, subsistence, and incidential expenses incurred by contractor personnel in official company business are allowable....

In addition, the Contractor claimed unallowable costs totaling $58,930 in FY 1985 and $124,182 in FY 1986 for the business use of Contractor-owned automobiles. The average cost per mile of these automobiles exceeded the reasonable amount ($0.205 in FYs 1985 and 1986) in accordance with the Federal Travel Regulations (FTR). These costs are unallowable in accordance with the Medicare agreements, Appendixes B, Section XII, which states:

> The cost of automobiles include...The reasonable cost of such automobiles which may be charged to this agreement/contract shall be the actual cost not to exceed the rate published in the Federal Travel Regulation....

We reduced this finding by the Contractor-owned automobile costs that were charged to the cost centers disallowed in the Unallocable Costs finding earlier in this report.

Finally, the Contractor claimed $4,645 in FY 1986 of compensation paid to certain executives for the income taxes on Contractor-owned automobile personal use charges. These costs are unallowable in accordance with FAR

31.201-6(a), which states:

> When an unallowable cost is incurred, its directly associated costs are also unallowable.

Recommendation

We recommend that the Contractor make the following adjustments to its FACPs:

	Part A	Part B
Costs not associated with an operation		
FY 1985	$ 65,969	$43,079
FY 1986	110,390	92,973

In addition, we recommend that the Contractor strengthen its internal control procedures for determining the allowability of Contractor-owned automobile costs.

Contractor Response

The Contractor concurred with part of this finding, but disagreed with the portion related to the personal use of automobiles. It stated that a corporate automobile involves both a fixed cost not related to use, other than that originally justifying the automobile, and the variable cost for both business and personal use. Because eliminating personal use does not eliminate the fixed cost, the Contractor's practice is to charge employees only for the variable cost associated with personal use. The Contractor agrees that FAR 31.205-46(f) clearly disallows the personal use cost, but stated that FAR does not specifically deal with the methodology for computing personal use cost.

The Contractor also did not agree with our computation of the unallowable automobile costs related to business use, because it included both return-on-investment and fleet vehicle service costs as automobile costs. The Contractor stated that return on investment is allowable for contractors investing funds in assets used to administer the Medicare program, and is not a travel or automobile expense. In addition, it stated that costs for managing the fleet vehicle program are also not directly related to the automobiles. The Contractor stated that these cost items should be excluded from the calculation of unallowable automobile costs.

Auditors' Additional Comments

We do not agree with the Contractor's position that the automobile fixed cost should not be included in determining the costs allocable to personal usage. The Medicare agreement, Appendix B, defines the costs of an automobile, which include both fixed and variable costs. All automobile costs should be allocated to both personal and business objectives using an equitable allocation basis.

We also do not agree with the Contractor's position that return-on-investment costs and fleet vehicle program management costs are not directly related to the automobiles and are, therefore, not automobile costs. The Contractor would not be entitled to return on investment, if it did not own the automobiles. Fleet vehicle management costs were also incurred solely because of the automobile-ownership. These costs are clearly directly related to Contractor-owned automobiles and should be included in computing the cost of owning such automobiles.

The finding amount would not change if HCFA agreed that fixed costs were only assignable to business usage. The actual cost per mile exceeded $0.205 even if return-on-investment costs and fleet vehicle management costs are excluded from the cost-per-mile computation. Accordingly, fixed costs allocable to personal use would be disallowed as excess business costs. Allowable automobile costs should be limited to $0.205 per Medicare business mile. This finding remains unchanged.

CLAIMED COSTS EXCEEDING THE APPROVED BUDGET

The Contractor claimed costs exceeding its Notices of Budget Approval (NOBA) totaling $146,829 in FY 1985 and $78,314 in FY 1986. These costs are unallowable in accordance with the Medicare agreements, Article VI (Part A), and Article XVI (Part B), which state:

> Such budgeted amounts for the purpose of obligation of funds by the Secretary shall be a ceiling which the Intermediary [Carrier] may not exceed without the prior approval of the Secretary....

The FY 1985 Part A amount included Arkansas system implementation costs of $104,361 that are also unallowable, because they exceeded the HCFA-approved amount for this project. The FY 1986 Part A amount of $73,935 is unallowable, because it exceeded the HCFA-approved fixed-price amounts for the Claims Operations lines 1 and 2. The remaining $42,468 in FY 1985 and $4,379 in FY 1986 as well as the FY 1986 Part A amount of $73,935 are otherwise allowable and should be reduced to the extent that other findings result in sustained disallowances.

Recommendation

We recommend that the Contractor make the following adjustments to its FACPs:

Operation	FY 1985	FY 1986
Part A:		
Productivity Investments	$104,361	
Costs-Not Associated With an Operation	39,490	
Bills Payment		$73,935
Part B:		
Physician Fee Freeze	2,978	
Other		4,379

In addition, we recommend that the Contractor strengthen its internal control procedures for monitoring actual versus budgeted expenditures.

Contractor Response

The Contractor did not concur with this finding and stated that it included expenses exceeding the approved budget on its FACPs to document all expenses applicable to the Medicare operations. Because funds were not drawn for these excess expenses, however, no repayment will be due and this should not be a dollar finding. The Contractor also stated that excess costs totaling $42,468 in FY 1985 and $14,848 in FY 1986 should be used to offset other cost disallowances. It agreed that Arkansas system implementation costs should be limited to the HCFA-approved amount, but stated that the excess are valid replacement costs for other disallowed costs.

The Contractor commented further on these costs in its response to the Costs Incurred But Not Claimed finding. These comments are summarized below.

FY 1985 (Part A): The Contractor stated that $5,000 of unallowable pension costs were charged to the Arkansas system implementation recipient code. Additionally, the Contractor included $7,257 of pension costs in the Arkansas system implementation costs that were not charged to this recipient code but were manually adjusted from the Part A recipient code. Accordingly, the $104,361 of unallowable costs exceeding the NOBA should be reduced by $12,257.

The Contractor also stated that $39,490 of costs exceeding the NOBA resulted from net differences on several FACP line operations. Because the Part A findings clearly reduce the Part A expenses below the NOBA, the $39,490 originally exceeding the NOBA should now be reimbursable.

FY 1985 (Part B): The Contractor stated that $2,978 of costs exceeding the NOBA was included on the Physician Fee Freeze line operation. Because the Part B findings clearly reduce the Physician .Fee Freeze costs below the NOBA, these costs should now be reimbursable.

FY 1986 (Part A): The Contractor stated that it incurred $617,757 of Arkansas system implementation costs that it did not claim. These costs included $25,100 of unallowable pension expense that was charged to the Arkansas system implementation recipient code, and $1,923 of pension expense that was manually adjusted from the Part A recipient code. Because these costs were not claimed, the Pension Costs finding should be adjusted.

The Contractor also stated that the net $10,469 exceeding the NOBA related to its Claims Operations (Lines 1 and 2), which were capped at $2 for the first 1,393,000 claims processed and $1.50 for any additional claims. The amount exceeding the NOBA for these operations was justified by higher claim volumes. Accordingly, the $10,469 should be reimbursed as part of the FACP audit settlement.

Fiscal Year 1986 (Part B): The Contractor stated that the $4,379 exceeding the NOBA related to the COBRA Participating Physicians line operation. Because the Part B findings clearly reduce the COBRA Participating Physicians costs below the NOBA, these costs should now be reimbursable.

Auditors* Additional Comments

Costs claimed exceeding the approved NOBA are unallowable, because the budget represents a ceiling that may not be exceeded without the prior approval of the Secretary. The Contractor did not provide supporting documentation for such approval. Our opinion is based on the costs claimed on the FACPs and not those that were reimbursed by the Secretary. Accordingly, this finding remains the same. It should be reduced, however, to the extent that other findings result in sustained disallowances as discussed below.

FY 1985 (Part A): We agree that the unallowable Pension Costs finding included $4,660 charged to the Arkansas system implementation recipient code. This amount excludes a portion of the $5,000 for allowable deferred compensation and actuary fees. Accordingly, if HCFA sustains the pension finding, the $104,361 of Arkansas system implementation costs exceeding the NOBA should be reduced by $4,660. We also agree that the Pension Costs finding included $4,863 (net of allowable deferred compensation and actuary fees) that was included in the Arkansas system implementation costs as a manual adjustment. If HCFA sustains the pension finding, the $104,361 of Arkansas system implementation costs exceeding the NOBA should be reduced by $4,863 also.

The remaining $39,490 exceeding the NOBA should be reduced to the extent that HCFA sustains the other findings.

FY 1985 (Part B): We agree that the $2,978 of Physician Fee Freeze costs exceeding the NOBA should be reduced if HCFA sustains the other findings.

FY 1986 (Part A): We agree that the draft report Pension Costs finding included $23,311 charged to the Arkansas system implementation recipient code, and $1,143 that were manually adjusted from the Part A recipient code. These amounts are net of allowable deferred compensation and actuary fees. Because these costs were not claimed in FY 1986, we revised the final report pension finding to delete these costs.

Based on the Contractor's response, we noted that the costs exceeding the NOBA for the Claims Operations line items were $73,935. These costs are unallowable because they exceeded the fixed-price ceiling for these line items. We revised the draft report finding accordingly. This finding, however, should be reduced if HCFA revises the NOBA to adjust for a higher-than-budgeted claims volume, or to the extent that HCFA sustains the other findings for the Claims Operations line items.

FY 1986 (Part B): We agree that $4,379 of COBRA Participating Physicians costs exceeding the NOBA should be reduced if HCFA sustains the other findings.

COMPLEMENTARY INSURANCE CREDITS

The Contractor claimed unallowable costs associated with its complementary insurance program totaling $155,644 in FY 1986. These costs are unallowable for the following reasons.

The Contractor made mathematical errors in computing its complementary insurance credits in October 1985 and May 1986, when the credits were based on a set rate for each complementary claim. The credit calculations erroneously included the Federal Employee Program claims. The complementary insurance credits were overstated by $(414) for Part A and $(2,104) for Part B.

Beginning in May 1986, the Contractor developed a methodology to allocate to its private business the actual costs of processing complementary insurance claims. However, the Contractor determined the amount using budgeted rather than actual amounts. In addition, the methodology did not include an allocation of overhead costs to its private business. For these reasons, the Contractor understated its complementary insurance credits from May 16, 1986, through September 30, 1986.

Section 1601.C of the Contractor's Medicare intermediary manual states:

> ...charges to the complementary insurer are determined by cost allocation. As used in this section, the term allocation means to distribute all costs to Medicare and complementary insurance in such proportion as to reflect the benefits received by each program. In selecting the appropriate method of allocation consider the benefits derived from each function. Where mutual benefits are derived full cost sharing is required....
>
> When allocating costs to complementary insurance, observe the following principles:
>
> - Charge all direct costs to the appropriate line of business.
>
> - Prorate indirect costs on an appropriate basis subject to audit.

We determined costs that should have been allocated to the Contractor's private business using the following method. We computed the **FY** 1986 costs to process a claim [actual costs included in the bills payment (Part A) and claims payment (Part B) FACP operations divided by total workload] and divided it by two. We subtracted the Contractor's rates used to compute the credits for this period from the results and multiplied the differences by the number of complementary claims processed from May 16, 1986, through September 30, 1986. Unallowable costs totaled $40,846 (Part A) and $117,316 (Part B).

Recommendation

We recommend that the Contractor make the following adjustments to its **FY** 1986 **FACPs:**

	Part A	Part B
Bills Payment	$ 40,432	
Claims Payment		$115,212

In addition, we recommend that the Contractor strengthen its internal control procedures to assure that complementary insurance program costs are properly allocated in the future.

Contractor Response

The Contractor concurred with part of this finding; it agreed with the adjustments for the mathematical errors. It did not agree, however, with the May 16, 1986, through September 30, 1986, adjustments for budgeted crossover rates. The Contractor recalculated its crossover rates using actual FY 1986 claims processing expenses and stated that the recalculated rates clearly show that its budgeted rates were reasonably developed.

Auditors* Additional Comments

We reviewed the Contractor's calculation of its crossover rates based on actual **FY** 1986 claims processing expenses. Except for a few minor discrepancies, which did not affect the rates, the calculations were adequately supported and mathematically correct. The Contractor, however, excluded certain direct and indirect cost centers from its allocation to the complementary insurance program; it also included adjustments, deletes, and reopenings in its number of claims processed, used to calculate the crossover rates. Without further on-site review, and **HCFA's** technical assistance, we could not determine whether this methodology is equitable. Therefore, we recommend that HCFA review the technical aspects of the Contractor's rate calculation methodology, prior to its final determination of allowable costs.

TAXES

The Contractor-claimed $33,027 in FY 1985 and $86,373 in FY 1986 of unallowable taxes. These costs are unallowable for the following reasons.

The Contractor claimed $85 in FY 1985 and $10,325 in **FY** 1986 of unallowable Indiana gross income taxes (IGIT) and $12,553 in FY 1985 and $55,610 in FY 1986 of unallowable personal property taxes, because it allocated these costs to Medicare based on budgeted amounts. The Contractor did not adjust the allocation bases at fiscal year end to determine the actual taxes that were allocable to the Medicare program. These costs are unallowable in accordance with FAR 31.201-4 which states:

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

In addition, the Contractor claimed $20,389 in FY 1985 and $20,438 in FY 1986 of unallowable deferred taxes that were for its non-Medicare business. These costs are unallowable in accordance with the Medicare agreements, Appendixes B, Section XV.

Recommendation

We recommend that the Contractor make the following adjustments to its **FACPs**:

	Part A	Part B
Costs not associated with an operation		
FY 1985	$23,471	$ 9,556
FY 1986	29,538	56,835

In addition, we recommend that the Contractor strengthen its internal control procedures for determining the allowability and allocability of taxes.

Contractor Response

The Contractor concurred with this finding and stated that it implemented changes to provide for more accurate calculations of its Indiana gross income and personal property taxes. It also stated that deferred taxes were allocated to Medicare in CY 1985 but should not have been, and, that after January 1, 1986, they were no longer allocated to Medicare.

COSTS CLAIMED IN ERROR

The Contractor claimed $110,541 of unallowable costs resulting from accounting errors. The Contractor made manual adjustments to its cost reporting system to arrive at the costs claimed on its FACPs. Cur review of these adjustments disclosed the following errors:

- The Contractor did not credit its FY 1985 FACP (Part B) for subcontract costs that were accrued at the end of FY 1984. Unallowable costs totaled $85,839.

- The Contractor claimed adjustments for compensated absences (Part B) and rent (Part A) in FY 1985 but erroneously did not adjust its Parts A and B FACPs, respectively. The Contractor should have reduced its FACPs by $8,492 for compensated absences (Part A) and $10,300 for rent (Part B). Therefore, these costs are unallowable. The Part B credit adjustment was, however, recorded in FY 1986; therefore, the Contractor understated FY 1986 costs by $10,300.

- The Contractor erroneously did not calculate manual adjustments for several employee cost center changes reported after the costs had been allocated. This resulted in unallowable costs of $19,334 for Part A and $(3,876) for Part B for FY 1985.

- The Contractor claimed $647 in FY 1985 and $105 in FY 1986 of unallowable photocopy costs caused by clerical errors in calculating the Part B costs.

Recommendation

We recommend that the Contractor make the following adjustments to its FACPs:

	Part A	Part B
Costs not associated with an operation		
FY 1985	$27,826	$ 92,910
FY 1986		(10,195)

In addition, we recommend that the Contractor strengthen its internal control procedures to assure that manual adjustments are properly calculated and claimed, and that clerical errors do not go undetected in the future.

Contractor Response

The Contractor concurred with part of this finding; its response to each adjustment is summarized below.

Subcontract Accrual Reversal. The Contractor agreed with this adjustment.

Compensated Absences. The Contractor agreed with the $8,492 FY 1985 cost reduction, but stated that it should be added to FY 1986 costs as an accrual reversal. It also stated that the Part B FY 1985 compensated absence adjustment should be added to FY 1986 costs as an accrual reversal.

Photocopy Charneback. The Contractor agreed with this adjustment.

Rent Variance. The Contractor agreed with both the FYs 1985 and 1986 adjustments.

Employee Cost Center Changes. The Contractor agreed with part of this adjustment. It stated that the dollar amount should be revised, because one employee was retained to work on Medicare operations. His salary and benefits, although included on the manual adjustment worksheet, were intentionally not part of the FACP adjustment.

Auditors' Additional Comments

Additional comments for those adjustments that the Contractor did not concur with follow:

Compensated Absences. We do not agree that the compensated absence adjustments should be reversed in FY 1986. These adjustments were not cost accruals. The Contractor recorded compensated absence expense in December of 1984 and 1985. These adjustments reflect the difference between the December 1984 recorded expenses and the actual FY 1985 amounts based on 25 percent of the December 1984 costs and 75 percent of the December 1985 costs. Because the credit adjustments were made manually and not recorded in the FY 1986 accounting records, it is not appropriate to reverse the adjustments in FY 1986.

Employee Cost Center Changes: We reviewed Mr. Cooley's employee profile, which indicated that he was transferred from Cost Center 39215, Medicare A Administrative Support, to Cost Center 32300, Paperless Claims, effective March 18, 1985. This also is supported by the Contractor's response indicating that Mr. Cooley was retained to help with the Electronic Media Claims productivity investment. The recommended audit adjustment was to reduce Mr. Cooley's salary and fringe benefit costs that were charged 100 percent to Medicare A, based on Cost Center 39215 charges, to the allocable amount for both Medicare A and B using Cost Center 32300 allocation percentages. Accordingly, this adjustment is appropriate and the finding remains unchanged.

ADVERTISING AND PROMOTIONAL COSTS

The Contractorclaimed $18,602 in FY 1985 and $43,176 in FY 1986 of unallowable advertising and promotional costs. These costs were for promotional items, national advertising, and the sponsorship of the pre-Pan American games health and fitness show. These costs are unallowable in accordance with FAR 31.205-1(d) and the Medicare agreements, Appendixes B, Section XV.A.1 which state, respectively:

> The only advertising costs that are allowable are those specifically required by contract, or that arise from requirements of Government contracts....
>
> The following items are unallowable:...costs related to the acquiring or enrolling of new subscribers, including selling, advertising, and other promotional costs.

Recommendation

We recommend that the Contractor make the following adjustments to its FACPs:

	Part A	Part B
Costs not associated with an operation		
FY 1985	$10,479	$ 8,123
FY 1986	21,142	22,034

In addition, we recommend that the Contractor strengthen its internal control procedures for determining the allowability of advertising and promotional costs.

Contractor Response

The Contractor concurred with part of this finding; its response to each adjustment is summarized below.

Sales Awards. The Contractor concurred with this finding.

National Advertising. The Contractor stated that part of this finding related to costs charged to Account 70104: Newspaper Advertising, Cost Center 32300: Paperless Claims, which accumulated the costs related to the Electronic Media Claims productivity investment. Accordingly, a reasonable allocation of these costs to Medicare would be allowable. The Contractor concurred that Account 70808: National Advertising, should not have been allocated to Medicare and stated that it did stop allocating it in CY 1986.

Promotional Costs. The Contractor did not concur with this adjustment. It stated that the costs were charged to Account 70201: Public Affairs, and were for its sponsorship of an event called "A Celebration of Health and Fitness", a statewide event designed to encourage healthy lifestyles. This was a community service program that is reasonably allocable to Medicare in accordance with FAR 31.205-1(e)(3).

Auditors' Additional Comments

Additional comments for those adjustments that the Contractor did not concur with follow:

National Advertising. We reviewed the invoices charged to Account 70104, Cost Centers 32300 and 32530 (CY 1986) and determined that the costs were for paperless claims advertisements in various medical publications. Because establishing paperless claim capabilities was a HCFA-mandated project during the audit period, we determined that these costs are allowable costs arising from the contract requirements. Accordingly, we reduced the Fiscal Year 1986 draft report audit finding by $501 (Part A) and $1,012 (Part B).

Promotional Costs. The Contractor's event is not considered a community service activity per FAR 31.205-1(e)(3). This activity is clearly an unallowable special event, such as a convention or trade show. These costs remain unallowable.

PROFESSIONAL AND CONSULTING COSTS

The Contractor claimed $6,998 in FY 1985 and $53,776 in FY 1986 of unallowable professional and consulting costs. These costs include accounting, legal, actuarial, and other consulting fees that relate to the Contractor's affiliates, a national account review, and the Contractor's non-Medicare business. These costs are unallowable in accordance with the Medicare agreements, Appendixes B, Section XV.

Recommendation

We recommend that the Contractor make the following adjustments to its FACPs:

	Part A	Part B
Costs not associated with an operation		
FY 1985	$ 4,149	$ 2,849
EY 1986	31,893	21,883

In addition, we recommend that the Contractor strengthen its internal control procedures for determining the allowability of professional and consulting costs.

Contractor Response

The Contractor concurred with only part of this finding. It concurred with the auditing consulting, medical consulting, merger committee meeting, actuarial consulting, national accounts review, and other consulting (Account 75803) adjustments. It did not concur with the outside legal service adjustment (Account 75001) or that the auditing consulting finding indicated an internal control weakness. Its response to these two adjustments are summarized below.

Auditing Consultinn Fees. The Contractor concurred with this finding, which disallowed a few non-Medicare consulting invoices charged to cost centers that allocate 3 to 6 percent to Medicare. It stated that allocation bases are not designed to deal with every individual invoice; accordingly, it would be easy for certain invoices to be underallocated to Medicare as well. The Contractor also stated that it does not consider this to be a significant internal control weakness.

Outside Legal Services (Account 75001). The Contractor stated that the FY 1985 Medicare charges from this account were allocated from Cost Center 22000, Legal Division, and involved services for merging Blue Cross and Blue Shield.

The Contractor concurred with this adjustment, except for two payments to Roberts & Rydel in March and May 1985. It also stated that, depending on the disposition of the finding disallowing Cost Center 22000 in total, this finding may be duplicated.

The Contractor stated that the FY 1986 adjustment is primarily for damages and attorney fees related to a discrimination law suit by several former employees. The Contractor concurred with this adjustment, but did not agree that it was a sign of poor internal controls.

Auditors* Additional Comments

Additional comments for those adjustments that the Contractor did not concur with follow:

Auditing Consultinn Fees. The auditing consulting fees for the Contractor's non-Medicare business are specifically unallowable and should have been segregated from the pool of costs indirectly allocated to Medicare. The failure to segregate unallowable costs indicates an internal control weakness.

Outside Legal Services. The March and May 1985 payments were paid to Roberts, Ryder, Rogers and Scism. We reviewed office memorandums from Mr. Robert Arnold that specifically addressed the total amounts of these invoices and stated that none of the amounts should be applied to Government business. These costs remain unallowable.

We do, however, agree that the total FY 1985 adjustment was coded to Cost Center 22000, which was also disallowed under the Unallocable Cost finding. Only a small portion of the FY 1986 adjustment was coded to Cost Center 22000; the costs for the discrimination law suit were coded to Cost Center 20000. If HCFA sustains the Unallocable Cost finding, it should be reduced by $2,672 (Part A); $2,206 (Part B); $242 (Part A); and $13 (Part B) for FYs 1985 and 1986, respectively.

GAINS AND LOSSES ON THE SALE OF DEPRECIABLE PROPERTY

The Contractor did not claim $5,105 in FY 1985 and FY 1986 for the net losses on the sale of its depreciable property. The Contractor did not treat gains and losses as an allocable expense to the Medicare program in accordance with FAR 31.205-16(a), which states:

> Gains and losses from the sale, retirement, or other disposition.. .of depreciable property shall be included in the year in which they occur as credits or charges to the cost grouping(s) in which the depreciation or amortization applicable to those assets was included....

We determined Medicare's portion of the net losses for each fiscal year based on its depreciation allocation percentages.

Recommendation

We recommend that the Contractor make the following adjustments to its FACPs:

	Part A	Part B
Costs not associated with an operation		
FY 1985	$ (741)	$ (427)
FY 1986	(2,532)	(1,405)

In addition, we recommend that the Contractor strengthen its internal control procedures to assure that gains and losses on the sale of depreciable assets are allocated to Medicare in the future.

Contractor Response

The Contractor agreed that gains and losses on the sale of depreciable assets were not allocated to Medicare and should have been. It did not, however, agree with the dollar amount of this finding. It stated that the September 30 account balances used to compute the finding did not properly match the revenues with the corresponding asset writeoffs for the items sold. Journal entries were made in November to write off the net book values of assets sold before September 30 of each year. If these journal entries were reclassified to the correct fiscal years, the account balances would reflect losses in both years and the finding would be an increase to FACP costs.

Auditors* Additional Comments

We reviewed additional documentation to support the Contractor's adjusted account balances due to asset writeoffs made in November for assets sold prior to September 30 of each year. We agree that the adjusted account balances equaled losses of $13,714 and $47,319 in FY 1985 and FY 1986 respectively. We computed Medicare's portions of these losses and adjusted the audit finding accordingly.

OTHER UNALLOWABLE COSTS

The Contractor claimed $25,820 of unallowable costs for the reasons discussed below.

Travel and Entertainment

The Contractor claimed $2,837 in FY 1985 and $4,939 in FY 1986 of unallowable travel and entertainment costs. These costs included spouse travel, alcoholic beverages, first-class airfare, social club dues, and travel that did not benefit Medicare. These costs are unallowable in accordance with FAR 31.205-46(a)(l) and (d), 31.205-14, and the Medicare agreements, Appendixes B, Section **XV**. The FAR sections state, respectively:

> Costs for transportation, lodging, subsistence, and incidental expenses incurred by contractor personnel in official company business are allowable....
>
> The difference in cost between first-class air accommodations and less-than-first-class air accommodations is unallowable except when less than first-class accommodations are not reasonably available to meet necessary mission requirements....
>
> Costs of amusement, diversion, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable....

Blue Cross Association Dues

The Contractor claimed $6,592 in FY 1985 and **$(1,509)** in **FY** 1986 of unallowable Blue Cross Association (BCA) dues. The Contractor allocated BCA dues to Part B of the Medicare program; however, only Blue Shield Association dues are allocable to Part B. These ***costs*** are unallowable in accordance with FAR 31.203(b).

Blue Cross Association Wire System Costs

The Contractor claimed $2,864 in FY 1985 and $773 in FY 1986 of unallowable BCA wire system costs. These costs are not allocable to Medicare, because BCA bills HCFA directly on a fixed-rate basis for wire system costs.

Settlement Expense

The Contractor claimed $5,467 in FY 1986 of unallowable back pay for settling an age discrimination termination law suit. These cost are unallowable in accordance with FAR 31.205-6(h)(l), which states:

> Backpay resulting from underpaid work is compensation for the work performed and is allowable. All other backpay resulting from violation of Federal labor laws or the Civil Rights Act of 1964 is unallowable.

Financial Costs

The Contractor claimed $423 in FY 1985 and $2,803 in FY 1986 of unallowable financial costs for interest on the Board of Directors' deferred compensation. These costs are unallowable in accordance with FAR 31.205-20, which states:

> Interest on borrowing (however represented)...are unallowable.

Relocation Expense

The Contractor claimed $393 in FY 1986 of unallowable closing costs on the sale of employee homes. These costs exceeded the 14-percent limitation in accordance with FAR 31.205-35(a)(3), which states:

> Closing costs... incident to the disposition of actual residence owned by the employee when notified of transfer,...shall not exceed 14 percent of the sales price of the property sold.

Contributions

The Contractor claimed $12 in FY 1985 and $226 in FY 1986 of unallowable contribution costs. These costs are specifically unallowable in accordance with FAR 31.205-8.

Recommendation

We recommend that the Contractor make the following adjustments to its **FACPs**:

	Part A	Part B
Costs not associated with an operation		
FY 1985	$ 3,825	$8,903
FY 1986	10,450	2,642

In addition, we recommend that the Contractor strengthen its internal control procedures for determining and segregating unallowable costs.

Contractor **Response**

The Contractor concurred with the adjustments for BCA wire system costs, relocation expense, contributions, and settlement expense. It did not concur with the **dollar'amounts** of the travel and entertainment, and financial cost adjustments, and did not concur with the outside printing adjustment. Its response to these three adjustments are summarized below.

Travel and Entertainment. The Contractor concurred with this adjustment but stated that a portion of it was charged to Cost Center 23100, which was disallowed in its entirety in our report. It stated that if the cost center finding is sustained, this finding should be adjusted to avoid a duplicate cost adjustment.

Financial Costs. The Contractor concurred with this adjustment but did not agree with the dollar amount. It stated that, because part was charged to Cost Center 10002, and we questioned its Medicare allocation percentage, a minor part of this adjustment is a duplication.

Outside Printing: The Contractor did not concur with this adjustment. It stated that the two invoices in question were processed in November 1985, but were credited from Cost Center 31340 in December 1985. This finding should be passed.

Auditors? Additional Comments

Additional comments for those adjustments that the Contractor did not concur with follow:

Travel and Entertainment. We agree that $518 of this adjustment was duplicated in the Unallocable Cost finding. The unallowable travel and entertainment costs should be disallowed irrespective of **HCFA's** decision regarding the allocability of Cost ***Center*** 23100. If HCFA sustains the Unallocable Cost finding, however, it should be reduced by $518 to eliminate the duplicate adjustment.

Financial Costs. We agree that part of this finding was duplicated in the Unallocable Cost finding related to Cost Center 10002. If HCFA sustains the Unallocable Cost finding, it should be reduced by $193 for part A and $193 for part B to eliminate duplicate costs disallowed in this finding.

Outside Printing. We agree that the two invoices in question were credited from Cost Center 31340 in December 1985. We eliminated this adjustment from the final audit report.

STATE INSURANCE COMMISSIONER'S COSTS

The Contractor claimed $4,909 in FY 1985 and $5,508 in FY 1986 of unallowable state insurance commissioner audit costs. The Contractor did not incur these costs so that it could operate as a corporation, but so it could function as an insurer. The Contractor is not, however, functioning as an insurer under its Medicare agreements but rather as an administrator of the Medicare program. Therefore, the state insurance commissioner audit costs do not benefit the Medicare program and are unallowable in accordance with the Medicare agreements, Appendixes B, Section XV.

Recommendation

We recommend that the Contractor make the following adjustments to its FACPs:

	Part A	Part B
Costs not associated with an operation		
FY 1985	$1,908	$3,001
FY 1986	2,610	2,898

In addition, we recommend that the Contractor strengthen its internal control procedures for determining the allowability of state insurance commissioner audit costs.

Contractor Response

The Contractor did not concur with this finding. It stated that the annual state insurance commissioner's audit is required for insurance companies and focuses on the adequacy of reserves and thus a company's solvency. Because contractor solvency has at least a general application to the Medicare program and the expense is a routine cost of doing business, it is allowable and reasonably allocable to Medicare. The Contractor further stated that this issue has been debated in previous FACP audits of other contractors, with a final determination that the cost is allowable.

Auditors' Additional Comments

For the reasons discussed in this audit finding, the state insurance commissioner audit costs do not benefit the Medicare program and are, therefore, unallowable. The Contractor did not provide any documentation to support its statement that this issue has been previously debated and that the costs were determined to be allowable. This finding remains as is.

INDIANA GROSS INCOME TAX

The Contractor claimed IGIT based on its estimated fiscal year gross receipts. We computed the allowable taxes based on the following actual fiscal year gross Medicare receipts:

	Part A	Part B
FY 1985	$8,207,917	$15,198,505
FY 1986	$7,184,100	$12,240,976

We disallowed the differences between the claimed and allowable taxes as discussed in the Taxes finding earlier in this report.

Because the findings in this report will reduce the fiscal year gross receipts, the IGIT should be reduced accordingly. We did not compute the adjustments, because it should be based on the amount of sustained findings that cause the above gross receipts to decrease.

We recommend that HCFA compute the adjustments by multiplying the decrease in fiscal year gross receipts by the weighted average fiscal year IGIT rates which are 1.263 percent in FY 1985 and 1.213 percent in FY 1986.

Recommendation

We recommend that HCFA compute the allowable IGIT, once DHHS makes the final determination on the recommended disallowances in this report.

Contractor Response

The Contractor did not respond to this finding.

OTHER MATTERS

DHHS and HCFA requested that we specifically address several issues during our audit. These issues are discussed below.

SIGNIFICANT INCREASES/(DECREASES) IN COSTS BETWEEN YEARS

To assess significant variations in costs, we compared costs reported by operation on the Contractor's FACPs. Details of items that were investigated further because of large increases or decreases follow.

Fiscal Year 1985 Comnared to Fiscal Year 1984 (Part A)

Operation	% Increase (Decrease)	Description
Bills Payment	(21.9)	This decrease reportedly was because of an increase in efficiency over the prior year.
Medicare Secondary Payer	Infinite	This increase reportedly was because funding was available for the first time in FY 1985.
Productivity Investments	523.1	This increase reportedly was because of large prepayment credits in FY 1984 and funding for implementing the Arkansas system in FY 1985.
Other	(59.9)	This decrease reportedly was primarily because of a decrease in funding for the prospective payment system.

Fiscal Year 1985 Comnared to Fiscal Year 1984 (Part B)

Operation	% Increase (Decrease)	Description
Claims Payment	14.3	This increase reportedly was because of a 17.27-percent increase in claims volume and system implementation.
Beneficiary/Physician Inquiry	(36.7)	This decrease reportedly was because of a decrease in funding for this line operation.

Fiscal Year 1985 Compared to Fiscal Year 1984 (Part B)

Operation	% Increase (Decrease)	Description
Medical Review and Utilization Review	26.9	This increase reportedly was because of increased HCFA emphasis in this area.
Medicare Secondary Payer	Infinite	This increase reportedly was because this was a FY 1985 HCFA initiative.
Physician Fee Freeze	Infinite	This increase reportedly was because this was a FY 1985 HCFA initiative.
Productivity Investments	213.1	This increase reportedly was because the implementation costs for the new claims processing system were recorded on this line operation.

Fiscal Year 1986 Compared to Fiscal Year 1985 (Part A)

Operation	% Increase (Decrease)	Description
Bills Payment	(10.0)	This decrease resulted because the Contractor did not claim its total costs due to contract limitations.
Medicare Secondary Payer	100.7	This increase reportedly was because of increased HCFA emphasis in this area.
Productivity Investments	(78.1)	This decrease reportedly was because no Arkansas system implementation costs were claimed in FY 1986.
Other	(81.42)	This decrease reportedly was because the Indiana gross income tax was not reported on this line operation in FY 1986.

Fiscal Year 1986 Compared to Fiscal Year 1985 (Part B)

Operation	% Increase (Decrease)	Description
Claim Payment	(10.6)	This decrease resulted because the Contractor did not claim its total costs due to contract limitations.

Fiscal Year 1986 Compared to Fiscal Year 1985 (Part B)

Oneration	% Increase (Decrease)	Description
Beneficiary/Physician Inquiry	69.2	This increase reportedly was because of increased Contractor emphasis to shorten response time.
Medical Review and Utilization Review	34.9	This increase reportedly was because of increased HCFA emphasis in this area.
Medicare Secondary Payer	62.3	This increase reportedly was because of increased HCFA emphasis in this area.
Physician Fee Freeze	(62.8)	This decrease reportedly was because of a funding decrease once the program was established.
Productivity Investments	(82.5)	This decrease reportedly was because the new system installation costs were included on this line in FY 1985, and similar costs were not incurred in FY 1986.

SIGNIFICANT ELECTRONIC DATA PROCESSING EXPENDITURES

The Contractor implemented new claims processing systems for both Parts A and B; HCFA approved both these systems and included them in the FY 1985 Medicare budgets. In FY 1985, the Contractor exceeded its $225,000 budget for implementating the Arkansas Part A system by $104,361 and claimed these costs on its FACP. HCFA did not approve these costs and, therefore, they are unallowable. The $104,361 was included in the Claimed Costs Exceeding the Approved Budget finding in the Findings and Recommendations section of this report. In FY 1986, the Contractor incurred Arkansas Part A system implementation costs of $617,568. HCFA did not approve these costs, and the Contractor did not claim them.

For its Part B system, the Contractor incurred $1,582,737 in FY 1985, which included subcontract costs paid to Electronic Data Systems-Federal Corporation. HCFA approved these costs.

INTERIM EXPENDITURE REPORTS

We reviewed cumulative Interim Expenditure Reports from October 1, 1986, through August 30, 1987, along with preparation methods and procedures. Our limited review did not disclose any material inaccuracies or weaknesses.

COSTS INCURRED BUT NOT CLAIMED

The Contractor's FY 1986 Medicare agreements contained unit-cost target rates for each bill (Part A) and claim (Part B) processed for certain FACP operations, as follows:

- Part A: Bills Payment and Reconsideration and Hearings. $2 in FY 1986, $1.90 in FY 1987, and $1.81 in FY 1988.
- Part B: Claims Payment, Reviews and Hearings, and Beneficiary/Physician Inquiry. $1.78 in FY 1986, $1.65 in FY 1987, and $1.54 in FY 1988.

The Contractor is entitled to reimbursement for actual allowable costs incurred in FYs 1986 and 1987. Reimbursement exceeding the target rates in these years, however would reduce the FY 1988 unit target rates. These FY 1988 rates would be the maximum allowable rates for FY 1988. Rather than have its FY 1988 target rates reduced the Contractor chose not to claim $311,338 (Part A) and $1,959,255 (Part B) that caused it to exceed its FY 1986 unit target rates.

Contractor Response

The Contractor addressed both costs incurred but not claimed and replacement costs in its response to this finding. We have included the Contractor's comments related to replacement costs for FYs 1985 and 1986 after the Claimed Costs Exceeding the Approved Budget finding. The Contractor's comments regarding the FY 1986 costs incurred but not claimed are included in Item 2.D. of its response, and summarized below.

The Contractor stated that it had costs incurred but not claimed of $311,338 (Part A) and $1,959,255 (Part B) that exceeded its Claims Operations fixed-price ceilings in FY 1986. It stated that these expenses should be used as replacement costs for the portion of the FY 1986 findings that apply to the Claims Operations line items. Because most of the findings related to staff and support cost centers, the Contractor proposed allocating all of the findings except the Complementary Insurance Credits finding to the Claims Operations line items as follows:

Part A	
Total costs (lines l-2)	$ 3,236,873
Total costs (all lines less Implementation)	$ 7,505,907
Percent to total (lines 1-2)	43.12%
Part B	
Total costs (lines l-3)	$11,487,487
Total costs (all lines)	$14,200,182
Percent to total (lines 1-3)	80.90%

The Contractor stated that the Complementary Insurance Credits finding should be allocated 100 percent to Claims Operation line 1 for both Medicare A and B, because the complementary insurance credits were charged to these line operations.

Auditors' Additional Comments

Because we audited the total costs incurred, we agree that costs incurred but not claimed can be used to replace unallowable costs included in the Claims Operations line items. We agree with the Contractor that most of the findings were charged to indirect cost centers. We do not agree, however, with the proposed method of allocating the findings to the Claims Operations line items. The Contractor's FACP worksheets show an allocation of overhead expenses, including EDP costs, for Part A, to each FACP line item. Because the findings were mostly related to these overhead costs, the overhead costs rather than total FACP costs should be the basis for allocating the findings to Claims Operations. Accordingly, we recomputed the percentage of the findings that can be allocated *to* the Claims Operations and offset by the *costs* incurred but not claimed. Our computation follows:

Part A	
EDP and Overhead costs (lines 1-2)	$1,222,831
EDP and Overhead costs (all lines less Implementation)	$2,383,158
Percent to total (lines l-2)	51.31%
Part B	
Overhead costs (lines l-3)	$1,568,602
Overhead costs (all lines)	$2,065,315
Percent to total (lines l-3)	75.95%

We agree that the Complementary Insurance Credits finding should be allocated 100 percent to the Claims Operation line 1. We also can identify the Claimed Costs Exceeding the Approved Budget with specific FACP line operations, except for $39,490 of **FY** 1985 Part A costs. We revised Exhibits 1 through 4 to identify these findings with the appropriate line operations. The remaining findings were classified as costs not associated with an operation on these exhibits. We calculated the remaining findings allocable to the Claims Operations line items for FY 1986. We did not, however, include the Costs Exceeding the Approved Budget finding in the calculation. Instead we computed a revised costs exceeding the fixed-price ceiling for the Claims Operations line items. Our calculations follow:

	Part A (Lines 1 and 2)	Part B /Lines 1-3)
Costs claimed	$2,925,535	$ 9,528,232
Less unallowable costs	339.998'	610.954[b]
Subtotal	$2,585,537	$ 8,917,278
Costs incurred but not claimed	311.338	1.959.255
Net costs incurred	$2,896,875	$10,876,533
Less fixed-price ceiling	2.851.600	9.528.232
Net costs exceeding the fixed-price ceiling	$ 45,275	$ 1.348.301

The costs incurred but not claimed may be used to replace unallowable costs sustained by HCFA. However, after deducting sustained disallowances, and adding replacement costs, the total Claims Operations line items should not exceed $2,851,600 (Part A) and $9,528,232 (Part B), the NOBA amount for these line items.

OUT-OF-PERIOD COSTS

The Contractor prepaid postage expense at the end of FY 1983 and claimed the costs on its FY 1983 (Part B) FACP. In FYs 1984 and 1985, when the expenses were incurred, the Contractor made credit adjustments on the FACPs to account for the costs that had been claimed in FY 1983. The credit adjustment to the FY 1985 (Part B) FACP for out-of-period costs was $164,882.

FAR 31.201-2 states:

> The factors to be considered in determining whether a cost is allowable include...generally accepted accounting principles....

---

a [($583,835 x 51.31%) • ($114,367 - $73,935)]; see Exhibit 3 and notes.

b [($652,722 x 75.95%) + $115,212]; see Exhibit 4.

Generally accepted accounting principles require expense reporting in the period in which they are actually incurred. Reporting expenses in other periods distorts the accuracy and usefulness of financial information. In addition, prepaying expenses may be a direct violation of the Anti-Deficiency Act [31 USC 665(a)]. The Comptroller General has ruled:

> The Anti-Deficiency Act (among other things) forbids the incurring of obligations in advance of or in the absence of available appropriations to cover the obligation... Section 712(a) makes appropriations unavailable for goods or services which do not represent a bona fide need of the fiscal year sought to be charged...[B-1985741

This same Comptroller General decision also states:

> The "bona fide need" rule was developed by the General Accounting Office to implement one of the oldest funding statutes on the book. First enacted in 1789 (1 Stat. 95), the principle known as "the one year rule," now classified to 31 USC 712(a), is that annual appropriations may only be applied "to the payment of expenses properly incurred during that year or to the fulfillment of contracts properly made within that year."

We noted that the Contractor discontinued the practice of claiming out-of-period costs.

COTTON&COMPANY
CERTIFIED PUBLIC ACCOUNTANTS

100 SOUTH ROYAL STREET • ALEXANDRIA, VIRGINIA 22314 • (703) 836-6701 • TELECOPIER: (703) 836-0941

DAVID L COTTON, CPA
CHARLES HAYWARD, CPA
BRENDA N. BURZENSKI, CPA
MICHAEL W. GILLESPIE, CPA
ROBERT L. FLESHER, CPA
KEVIN P. MCFADDEN, CPA
CATHERINE L. NOCERA, CPA
ELLEN P. REED, CPA

OPINION ON FINAL ADMINISTRATIVE COST PROPOSAL

As described in the Findings and Recommendations section of this report and in the notes to Exhibits 1 through 4, Associated Insurance Companies, Inc., charged Medicare $2,530,409 of unallowable and unallocable costs. In our opinion except for these unallowable costs and except for the issues relating to out-of-period costs, the accompanying Final Administrative Cost Proposals present fairly in all material respects, the allowable administrative costs incurred under the Medicare agreements and recommended adjustments applicable to Parts A and B of the Health Insurance for the Aged and Disabled Program from October 1, 1984, to September 30, 1986 in accordance with the reimbursement principles of Federal Acquisition Regulation Part 31, as interpreted and modified by the Medicare agreements, in conformity with generally accepted accounting principles.

Our reports on internal control and compliance follow this page.

This report is intended to provide information to the Department of Health and Human Services and should not be used for any other purpose.

COTTON & COMPANY

By: David L. Cotton, CPA

April 24, 1990

REPORT ON REVIEW OF INTERNAL **CONTROL**

As part of our examination, we reviewed and tested the Contractor's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. The purpose of our evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Contractor's **FACPs.** Our study and evaluation was more limited than would be necessary to express an opinion on the Contractor's system of internal accounting control taken as ***a*** whole.

Contractor management is responsible for establishing and maintaining a system of internal accounting control. The objective of internal accounting control is to provide reasonable, but not absolute, assurance that (1) assets are safeguarded against loss from unauthorized use or disposition, and (2) financial records are reliable for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting controls should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

Certain inherent limitations ***exist*** that should be recognized ***in*** considering the potential effectiveness of any system of internal accounting controls. In performing most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. The effectiveness of some control procedures depends upon segregation of duties; these procedures can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management, either with respect to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risks that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

The significant elements of internal control required by the DHHS are:

- Accurate, current, and complete disclosure of the financial results of the Medicare program in accordance with Federal reporting requirements.
- Records that adequately identify the application of funds.
- Effective control over and accountability for all funds, property , and other assets.
- Comparison of actual with budgeted amounts for each period.
- Procedures for determining the allowability and allocability of costs in accordance with FAR Part 31, and Appendixes B of the Medicare agreements.
- Accounting records that are supported by source documentation.

Cur study and evaluation made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal control of the Contractor taken as a whole. However, based on our study of the significant control elements listed above, we believe that the Contractor's procedures were not adequate for DHHS purposes because of the conditions described below, which we believe are material weaknesses in relation to the agreements to which this report refers.

This report is intended to provide information to DHHS and should not be used for any other purpose.

UNALLOWABLE COSTS CHARGED TO THE MEDICARE PROGRAM

As discussed in the Findings and Recommendations section of this report, the Contractor charged Medicare **$2,530,409** of unallowable and unallocable costs. DHHS requires that a system of internal control include procedures for reviewing all costs to determine if costs are allocable and allowable. The failure to maintain an adequate accounting system that separates allowable and unallowable, and allocable and unallocable costs can result, as was the case here, in unallowable and unallocable costs being claimed for reimbursement.

Recommendation

We recommend that the Contractor strengthen its internal control procedures for identifying and segregating unallowable and unallocable costs.

INADEQUATE SUPPORTING DOCUMENTATION

The Contractor did not maintain adequate documentation to support the allocability of certain cost centers to the Medicare program. This deficiency resulted in unallowable costs being allocated to Medicare.

Recommendation

We recommend that the Contractor strengthen its internal control procedures to assure that the allocability of costs is supported in the future.

COSTS CLAIMED IN ERROR

The Contractor made mathematical and methodology errors in computing its manual adjustments to the costs allocated to Medicare, which resulted in unallowable costs claimed.

Recommendation

We recommend that the Contractor strengthen its internal control procedures to assure that errors are kept to a minimum and do not go undetected in the future.

REPORT ON COMPLIANCE

We audited the Contractor's FACPs from October 1, 1984, to September 30, 1986, and have issued our report thereon &ted April 24, 1990.

We conducted our audit in accordance with generally accepted auditing standards and ***Standards for Audit of Government Organizations, Programs, Activities, and Functions*** issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance that the FACPs are free of material misstatement.

Compliance with applicable laws and regulations related to the Medicare agreements is the responsibility of Contractor management. As part of obtaining reasonable assurance that the FACPs are free of material misstatement, we performed tests of compliance with certain provisions of laws and regulations related to the agreements. ***Our*** objective was not, however, to provide ***an*** opinion on overall compliance with such provisions.

Material instances of noncompliance are failures to follow requirements or violations of prohibitions contained in statutes, regulations, or the agreements that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the FACPs. The results of our tests of compliance disclosed the following material instances of noncompliance.

UNALLOWABLE COSTS CHARGED TO TEE MEDICARE PROGRAM

As described in the Findings and Recommendations section of this report, the Contractor charged Medicare **$2,530,409** of unallowable and **unallocable** costs. These costs are unallowable in accordance with FAR Part 31, and the terms and conditions of the Medicare agreements.

NONCONFORMITY WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

As described in the Other Matters section of this report, the Contractor reported certain costs in periods other than when they were incurred. FAR 31.201-2 requires the Contractor to account for and report costs in conformity with generally accepted accounting principles.

We considered these material instances of noncompliance in forming our opinion on whether the FACPs from October 1, 1984, through September 30, 1986, are presented fairly, in all material respects pursuant to the terms of the agreements and the FAR, in conformity with generally accepted accounting principles. Because of these material instances of noncompliance, our report on the FACPs contains a qualified opinion.

Except as described above, the results of our tests indicate that, for the items tested, the Contractor complied in all material respects with the provisions of applicable laws and regulations related to the agreements. For the items not tested, nothing came to our attention that caused us to believe that the Contractor had not complied, in all material respects, with those provisions.

This report is intended to provide information to DHHS and should not be used for any other purposes.

COTTON 6 COMPANY

By: ______________________________
David L. Cotton, CPA

Associated Insurance Companies, Inc.
Final Administrative Cost Proposal (Part A)
October 1, 1984, Through September 30, 1985

Operation	Administrative Costs Claimed	Recommended Adjustments	Footnote Reference
Bills Payment	$3,053,570		
Reconsideration and Hearings	109,629		
Medicare Secondary Payer	230,641		
Medical Review and Utilization Review	951,781		
Provider Desk Reviews	356,861		
Provider Field Audits	1,400,728		
Provider Settlements	306,191		
Provider Reimbursement	359,290		
Productivity Investments	633,583	$104,361	5
Other	116,677		
Costs Not Associated With an Operation		435,357	l-12
Total	$7,518,951	$539,718	

Cotton 6 Company's opinion on this final administrative cost proposal is on page 43.

Note 1. Recommended adjustment is for $279,019 of unallowable pension costs.

Note 2. Recommended adjustment is for $30,952 of unallowable costs.

Note 3. Recommended adjustment is for $(50,990) of return on investment costs.

Note 4. Recommended adjustment is for $65,969 of Contractor-owned automobile costs.

Note 5. Recommended adjustment is for $143,851 of costs exceeding the approved budget.

Note 6. Recommended adjustment is for $23,471 of unallowable taxes.

Note 7. Recommended adjustment is for $27,826 of costs claimed in error.

Note 8. Recommended adjustment is for $10,479 of unallowable advertising and promotional costs.

Note 9. Recommended adjustment is for $4,149 of unallowable professional and consulting costs.

Note 10. Recommended adjustment is for $(741) of losses from the sale of depreciable property.

Note 11. Recommended adjustment is for $3,825 of other unallowable costs.

Note 12. Recommended adjustment is for $1,908 of unallowable state insurance commissioner audit expenses.

Associated Insurance Companies, Inc.
Final Administrative Cost Proposal (Part B)
October 1, 1984, Through September 30, 1985

Operation	Administrative Costs Claimed	Recommended Adjustments	Footnote Reference
Claims Payment	$ 8,601,616		
Reviews and Hearings	585,925		
Beneficiary/Physician Inquiry	669,286		
Medical Review and Utilization Review	1,252,616		
Medicare Secondary Payer	171,548		
Physician Fee Freeze	490,538	$ 2,978	6
Productivity Investments	1,696,320		1
Other	191,905		
Costs Not Associated With an Operation		517,198	2-5, 7-13
Total	$13,659,754	$520,176	

Cotton & Company's opinion on this final administrative cost proposal is on page 43.

Note 1. The Office of Inspector General directed us to note the out-of-period costs finding in the section titled Other Matters, without classifying any related costs as recommended for adjustment. **Out-of-period** costs total **$(164,882)**.

Note 2. Recommended adjustment is for $344,123 of unallowable pension costs.

Note 3. Recommended adjustment is for $39,991 of unallowable costs.

Note 4. Recommended adjustment is for **$(34,910)** of return on investment costs.

Note 5. Recommended adjustment is for $43,079 of Contractor-owned automobile costs .

Note 6. Recommended adjustment is for $2,978 of costs exceeding the approved budget.

Note 7. Recommended adjustment is for $9,556 of unallowable taxes.

Note 8. Recommended adjustment is for $92,910 of costs claimed in error.

Note 9. Recommended adjustment is for $8,123 of unallowable advertising and promotional costs.

Note 10. Recommended adjustment is for $2,849 of unallowable professional and consulting costs.

Note 11. Recommended adjustment is for **$(427)** of losses from the sale of depreciable property.

Note 12. Recommended adjustment is for $8,903 of other unallowable costs.

Note 13. Recommended adjustment is for $3,001 of unallowable state insurance commissioner audit expenses.

Associated Insurance Companies, Inc.
Final Administrative Cost Proposal (Part A)
October 1, 1985, Through September 30, 1986

Operation	Administrative Costs Claimed	Recommended Adjustments	Footnote Reference
Bills Payment	$2,747,465	$114,367	5,6
Reconsideration and Hearings	178,070		
Medicare Secondary Payer	462,955		
Medical Review and Utilization Review	1,032,304		
Provider Desk Reviews	543,119		
Provider Field Audits	1,302,311		
Provider Settlements	397,966		
Provider Reimbursement	369,680		
Productivity Investments	139,024		
Other	21,675		
Costs Not Associated With an Operation		583,835	l-4, 7-12
Total	$7,194,569	$698,202[a]	

Cotton & Company's opinion on this final administrative cost proposal is on page 43.

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a Recommended adjustments allocable to the Bills Payment and Reconsideration and Hearings FACP operations total $339,998 (excluding the costs exceeding the NOBA adjustment). This amount may be replaced by costs incurred but not claimed to the extent these FACP operations do not exceed the $2,851,600 fixed-price ceiling (see pages 39-41).

Note 1. Recommended adjustment is for $235,651 of unallowable pension costs.

Note 2. Recommended adjustment is for $359,533 of unallowable costs.

Note 3. Recommended adjustment is for $(214,840) of return on investment costs.

Note 4. Recommended adjustment is for $110,390 of Contractor-owned automobile costs.

Note 5. Recommended adjustment is for $73,935 of costs exceeding the approved budget.

Note 6. Recommended adjustment is for $40,432 in'understated complementary insurance credits.

Note 7. Recommended adjustment is for $29,538 of unallowable taxes.

Note 8. Recommended adjustment is for $21,142 of unallowable advertising and promotional costs.

Note 9. Recommended adjustment is for $31,893 of unallowable professional and consulting costs.

Note 10 Recommended adjustment is for $(2,532) of losses from the sale of depreciable property.

Note 11. Recommended adjustment is for $10,450 of other unallowable costs.

Note 12. Recommended adjustment is for $2,610 of unallowable state insurance commissioner audit expenses.

Associated Insurance Companies, Inc.
Final Administrative Cost Proposal (Part B)
October 1, 1985, Through September 30, 1986

Operation	Administrative Costs Claimed	Recommended Adjustments	Footnote Reference
Claims Payment	$ 7,689,863	$115,212	6
Reviews and Hearings	706,181		
Beneficiary/Physician Inquiry	1,132,188		
Medical Review and Utilization Review	1,690,237		
Medicare Secondary Payer	278,374		
Physician Fee Freeze	182,700		
Productivity Investments	297,605		
Other	263,779	4,379	5
Costs Not Associated With an Operation		652.722	l-4, 7-13
Total	$12.240.927	$772.313'	

Cotton & Company's opinion on this final administrative cost proposal is on page 43.

a Recommended adjustments allocable to the Claims Payment, Review? end Hearings, and Beneficiary/Physician Inquiry FACP operations total $610,954. This amount may be replaced by costs incurred but not claimed to the extent these FACP operations do not exceed the $9,528,232 fixed-price ceiling (see pages 39-41).

Note 1. Recommended adjustment is for $286,343 of unallowable pension costs.

Note 2. Recommended adjustment is for $342,983 of unallowable costs.

Note 3. Recommended adjustment is for $(164,269) of return on investment costs.

Note 4. Recommended adjustment is for $92,973 of Contractor-owned automobile costs.

Note 5. Recommended adjustment is for $4,379 of costs exceeding the approved budget.

Note 6. Recommended adjustment is for $115,212 of understated complementary insurance credits.

Note 7. Recommended adjustment is for $56,835 of unallowable taxes.

Note 8. Recommended adjustment is for $(10,195) of costs claimed in error.

Note 9. Recommended adjustment is for $22,034 of unallowable advertising and promotional costs.

Note 10. Recommended adjustment is for $21,883 of unallowable professional and consulting costs.

Note 11. Recommended adjustment is for $(1,405) of losses from the sale of depreciable property.

Note 12. Recommended adjustment is for $2,642 of other unallowable costs.

Note 13. Recommended adjustment is for $2,898 of unallowable state insurance commissioner audit expenses.

APPENDIX A

Government Division

8320 Craig Street
Indianapolis, IN 46250

February 21, 1991

Ms. Catherine L. Nocera, CPA
Cotton & Company
Certified Public Accountants
100 South Royal Street
Alexandria, Virginia 22314

RE: Report on Audit of Medicare Administrative Costs
FY 1985 and 1986

Dear Ms. Nocera:

In response to your letter dated January 7, 1991, we have prepared the attached responses to the adjustments included in your draft audit report. As we discussed, we have included attachments as necessary to support our responses. The attachments for each section of our response are grouped at the end of that section. In a separate section, we have included documentation supporting a reasonable method for allocating your findings by line operation. As part of our response, we have also commented on our system of internal controls which is questioned in the draft report.

We appreciate your review and consideration of our comments before finalization of the audit report. We would be happy to discuss any of our comments or provide additional documentation upon request.

Sincerely,

Dennis W Brinker

Dennis W. Brinker
Controller
Government Division

DWB/pml

Enclosure

The Associated Group

Draft Report of Audit Findings

On the following pages, we have commented on each adjustment proposed in your report, and provided supporting documentation where appropriate.

Also included is a section detailing expenses that were unreimbursed on both the FY 1985 and FY 1986 FACP's that serve as replacement costs for costs denied through your audit findings. Unreimbursed costs are, of course, much greater in FY 1986 with the inception of a contract amendment which limited reimbursement for Part A and Part B Claims Operations.

Also included in this section is a suggested methodology for segregating your adjustments by line operation to the extent necessary to identify cost denials that can be replaced by unreimbursed costs. We believe this approach will reasonably allocate finalized adjustments by line operation.

Your report also questions the adequacy of the internal controls in place during the audit period. While we agree that errors were made on the FACP's, we do not agree that those errors identify any significant internal control weakness. The Pension issue represents approximately one-half of the effect of your findings and does not, in our opinion, represent an internal control weakness. It merely represents a significant change in the actuarial methodology for computing pension liability that was not completely finalized until after these FACP's were submitted. During the period as pension expense was allocated to Medicare, there was definitely intent to fund the pension.

As is noted in our individual responses, we disagree with several of the proposed adjustments and have documented necessary modifications to several others. Whatever the final disposition of individual findings, we believe a reasonable justification existed for allocating these costs and cost centers to Medicare. We did make a serious error in charging allocations from CC 30001 to Medicare, but the function of this center changed during the year without notice. As is explained in our response to this finding, we did identify this problem in January, 1987 and made adjustments to reclassify costs out of CC 30001. These credits did reduce Medicare expenses in FY 1987.

In summary, we understand the significant amount of dollar findings on this audit would indicate weak internal controls. Our position, on the other hand, is that the Pension finding is a one-time event which inflated the dollar effect of the audit and that we have supportable positions regarding many of the other audit findings as reflected in the following pages.

FACPb2

PENSION COSTS

This finding denies all pension expense charged to Medicare for both FY 1985 and FY 1986 based on our actuarial valuations for those years which indicated that no funding contributions were necessary. These actuarial determinations involved a change of methodology to the "Projected Unit Credit Cost Method". It was this change which resulted in funding being unnecessary. For both years under review these actuarial valuations were not completely finalized until after the FACP's were submitted. During both years we did do some interim funding of Pension Expense under the assumption that we would do normal year end funding.

Based on the above we accept the audit finding except for the following modification we consider appropriate:

1 The Part A Accumulation of Pension Expense charged to Medicare includes the following expenses directly applicable to the Arkansas implementaion (Recipient Code 050220):

FY 1985	$ 5,000
FY 1986	$25,100

As we overspent our FY 1985 HCFA approved budget for this implementation by over $100,000 and received no funding at all in 1986, these amounts should be backed out of your adjustment. We will cover this area in more detail in the section "Costs Incurred But Not Claimed" as we document unreimbursed expense available to replace cost eliminated through your findings.

MC85/al

UNALLOCABLE COSTS

This group of adjustments deals with allocation of "Staff and Support" costs to the Medicare Program. Medicare allocations from several of these costs centers were either partially or fully denied after audit review. Our response to each adjustment is as follows:

1 CC 24536 - Executive Loaned: As noted, this cost center housed expenses for an employee who was loaned to the Pan American Games organizing committee. A small port ion of the expenses was allocated to Medicare apparent 1 y based upon headcount. This cost represented a community service that was reasonbly allocable to Medicare. Though the cost center performs no direct service to the Medicare contract, this type of administrative expense is allowable for Medicare based on FAR Section 31.201-1(e)(3).

2 CC 30001 - EVP Pool : This cost center was first used in January, 1986 and included primarily:

  1 Executive search fees paid in the recruitment of corporate vice-presidents;

  2 Consulting costs related to the Claim Pro system implementation.

It appears the original plan was to include recruiting costs here with appropriate al location to Medicare on the "Equal to Markets" basis. As we moved through 1986 two problems occurred:

  1 The search firm invoices we could substantiate were not related to executive positions that should allocate to Medicare, and

  2 We began to accumulate the system implementation costs here that also had no benefit to Medicare.

When these changes occurred, the Medicare al location percentages were not changed and inappropriate costs were allocated to Medicare.

Though the audit adjustment is basically appropriate, it does not take into account correcting entries made to this cost center during the period October - December, 1986. During this period we reclassified most if not all of the system implementation costs out of this cost center to a systems cost center that did not allocate to Medicare, part ial ly correcting the overal locat ions made previously. (the attached schedules support the reclasses out of CC 30001). These negative allocations to Medicare did serve to reduce reported Medicare expenses in FY 1987.

Since the reclassifications/corrections to this cost center in October - December, 1986 do apply to expenses incurred prior to September 30, 1986, we believe that the negative cost allocations to Medicare in those three months should serve to reduce the finding you have identified as follows:

	FY 1986 - A	FY 1986 - B
Your FACP cost reduction	$218,428	$218,428
10/86 - 12/86 Negative allocation to Medicare (support attached)	(137,118)	(137,118)
Revised finding	$ 81,310	$ 81,310

3 cc 30500 - Healthcare Operations Support: This cost center allocated to Medicare only for a short period during 1986. As no support for the allocation to Medicare could be found, we accept this adjustment.

4 CC 31460 - National Division: Allocations to Medicare were made only in August and September, 1986. As we have not found specific support, we accept this finding.

5 cc 31470 - Affiliates: We accept this adjustment as it represents only one $19 allocation in July, 1986.

6 CC 31480 - Consumer Division: As we were not able to find supporting documentation, we accept this adjustment.

7 cc 33300 - Consumer Division Marketing: The allocations to Medicare were almost entirely in the period October - December, 1984. Since we have not found support for the adjustment, we will accept the finding. The $4 amount allocated to Part A in FY 1986 was backed out of expenses as a manual adjustment before the FACP was filed.

8 CC 10002 - Board of Directors: We allocated this cost center to the various markets consistently with other basic administrative cost centers. The auditors decided that a share should be allocated to managing our investments. We believe our approach to the allocation was reasonable, but do accept this finding.

9 cc 10003 - Executive Assistant to B.S. President: We had allocated 10% of this cost center to Medicare Part B based on an estimate of specific duties performed. The auditor's adjustments in effect uses the "Equal to Markets" approach. If this adjustment is to stand, a corresponding share of the cost should be allocated to Part A.

10 CC 26111 - Accounting: Again the adjustment provides for an allocation of the cost center to investments and reduces the Medicare allocation proportionately. We do not believe the Accounting Department was that heavily involved in accounting for investments at that time, but do accept this finding.

11 CC 31345 - Record Center: Effective January 1, 1986 the Records Center and Forms/Graphics were broken out into separate cost centers for the first time. We agree with your basic premise that Medicare allocation percentages were not properly revised when this segregation occurred.

Though adjustment is necessary, our review of your supporting workpapers and discussion with applicable personnel do identify some changes to your calculation. Your workpaper 5308 5/15 and 6/15 is a copy of the 1986 Cost Allocation Input Document specifically for the Record Center. We believe these percentages should be used to adjust the Record Center (CC 31345) allocation to Medicare. The sample detail on workpaper 5308 10/15 also supports the total Government share of records actively used to develop the Medicare allocations on 5308 6/15. We have attached copies of these workpapers as support.

Using the allocation percentages we suggest would modify your adjustment to Cost Center 31345 as follows:

Total Cost $132,122.03 X 2.65% = $3,501 Part A Allocation
X 6.85% = $9,050 Part B Allocation

	PART A	PART B
Adjusted allocation above	$3,501	$9,050
Allocated Per FACP	(11,574)	(22,078)
Revised Disallowance	(8,073)	(13,028)
Disallowed - Draft Report	(10,200)	(18,537)
Suggested Revision	$2,127	$5,509

12 cc 31340 - Forms and Graphics: Forms and Graphics became a separate cost center effective January 1, 1986. As noted in our response on the Records Center, we failed to update the allocation percentages when this cost center was established.

Again, we agree that an adjustment is necessary, but through review of your workpapers have identified somewhat different percentages. First, the allocation input document on Workpaper 5308 5/15 and 6/15 is specifically for the Records Center, not Forms/Graphics. Without a specific allocation document we moved to Workpaper 5308 7/15 (attached) which includes a six month summary of Forms/Graphics usage.

After correcting mathematical errors on this schedule and re-accumulating direct hours (including subsidiaries) this schedule reflects 20.8% of Forms and Graphics being allocated to Government.

The more important question with this cost center is how to segregate the Government allocation among Medicare A, Medicare B, and Medicaid. To determine the share of this Government allocation applicable to Medicare A and B we reviewed your workpapers 5308 13/15 - 15/15. These schedules list three months of help requests to Forms/Graphics, and for each request identify the cost center and market involved.

These schedules reasonably support the total allocation percentage for Government and provide a basis for segregating the allocation between Medicare and Medicaid. Of those Government requests clearly assignable by cost centers 85.7% are applicable to Medicare. In our opinion this sample of requests is the best method available to segregate the Government allocation. The percentages on your Workpaper 5308 8/15 - 9/15 were supplied by the Finance area and were apparently calculated based on number of claims processed. Discussion with the former manager of these areas indicated actual requests would be more appropriate for Forms/Graphics cost allocation. Copies of the referenced workpapers are attached.

Based upon this analysis the following modification of your Forms/Graphics adjustment is appropriate:

Allocation % - Total Government		- 20.8%
Medicare A	29.5%	- 6.1%
Medicare B	56.2%	- 11.7%
Medicaid	14.3%	3.0%
Total	100%	

Total Cost (CC 31340) $211,876.33 X 6.1% = $12,924 Part A Allocation
x 11.7% = $24,790 Part B Allocation

	PART A	PART B
Adjusted Allocation Above	$12,924	$24,790
Allocated Per FACP	(18,560)	(35,405)
Revised Disallowance	(5,636)	(10,615)
Disallowed - Draft Report	(12,945)	(20,891)
Suggested Revision	$ 7,309	$10,276

13 CC 24220 - Risk Management: We accept this adjustment. We were able to document our al location basis here but it did allocate incorrectly to Medicare, especially Medicare B.

14 CC 31530 - New Products: This is a systems area cost center responsible for the implementat ion of new systems and enhancements. Personnel in this cost center were involved in the Part A Arkansas system implementation and correctly allocated their time to the system implementation recipient code through February, 1986 when the system was put into use. Of the adjustment made, $17,731 of the cost was allocated to Medicare A in March - May, 1986 and appears to be continued follow up and problem solving after implementat ion. We believe that at least this part of the cost al located from CC 31530 should be al lowed.

15 CC 23100 - Public Relations: In Calendar Year, 1985 the Public Affairs area was combined with some port ion of our Advert ising cost in Cost Center 23100. Through December 31, 1985 none of this cost was allocated to Medicare. Effective January 1, 1986 Advertising costs were more completely segregated into Cost Center 23150. The following details the breakout of total expense between Medicare fiscal years:

	FYE 9/30/85	FYE 9/30/86
CC 23100 - Publ ic Affairs	$1,284,440	$ 291,331
CC 23150 - Advertising	$ 364,103	$2,263,242

Of the $291,331 in CC 23100 only $206,685 of expense was charged after January 1, 1986 when we started allocating a share of this cost center to Medicare. We made no allocation of CC 23150 to Medicare in either year.

Starting at January 1, 1986 we allocated 5.66% of expenses to Medicare A and 5.66% to Medicare B using the "Equal to Markets" approach. Since this methodology was chosen, we did not maintain specific allocation documentation for the cost center. The audit finding denies the entire Medicare al location from this cost center based on the idea that the function of this area was lobbying.

The attached Cost Center Profile for 1986 lists several functions performed by this unit. While there is a lobbying function identified here, several other tasks are performed that do relate to performance of our Medicare contracts. I discussed these functions with Stan Huseland who managed this unit during the audit period.

Within the function "Liaison with Congressmen" was the handling of Congressional Inquiries. Congressmen often inquire for their constituents regarding claim status or denials. Many of these inquiries relate to Medicare claims. The Public Affairs area coordinated logging inquiries, obtaining appropriate answers from the units, and making response to the Congressmen. Public Affairs performed this coordination for Medicare during the entire audit period. Also under the Congressional Liaison program Mr. Huseland and one of his employees coordinated and participated in annual Congressional Office Staff Medicare training and education conferences.

Other duties performed in Public Affairs that affect our performance of the Medicare contract are as follows:

1 Liaison with the news media - with the multitude of program changes, etc. in Medicare many media requests/questions are received. This unit, in coordination with personnel from Medicare Operations, responds to those questions.

2 The Governmental Affairs section of this area accumulates management information on the direction of government programs including Medicare.

3 Assists Medicare management in communicating our performance/ problems to governmental agencies and congressional delegations.

Though we agree that some lobbying is performed in this area, we believe a 11.32% total allocation to Medicare is justified and reasonable cost. FAR Regulation 31.205-1(e) also supports the allowability of the functions described above.

In summary, we believe the narrative information provided above supports the entire share of the expense we allocated to Medicare. Additionally, since the same functions were performed in FY 1985, we believe we were mistaken in not allocating a share of this cost to Medicare during the period 10/1/84 - 12/31/85. A calculated allocation based upon the allocation method used during 1986 would be reasonable.

16 CC 30110 - Performance Improvement Office: The allocation to Medicare from this cost center was adjusted to use a total corporate dollar ratio as the basis. We were not given workpapers to support the dollar ratio used but 5.91% for FY 85 Medicare A and 5.07% for FY 86 Medicare A seem low.

We believe our original allocations to Part A and Part B are reasonable but will accept a change to a corporate dollar ratio allocation if the change is made consistently. We do not agree with using the lower of our original allocation or the auditor's revised method. If the Part A allocation is to be changed, Part B must be adjusted also, even if the allocation increases.

17 CC 30100 - Strategic Planning: The adjustment to base the allocation on the combined allocation of its two reporting cost centers appears reasonable in general. The main problem with this approach is that it does not deal with the Special Project managers housed in CC 30100. The attached Cost Center Profile and memo document that project manager's time affected the allocation of cost and that one of those project managers, Janell Knetzer, managed the Medicare A Arkansas system implementation. This project is the reason for the increased Medicare A allocation in FY 86.

The extra Part A allocation for the Project Manager should have been made to the Arkansas Implementation recipient code through February, 1986 when the system was put into use. Follow-up work after March 1, 1986 is chargeable to the Part A recipient code. This approach would reduce the adjustment to Part A for FY 1986 by $19,443 (attached Cost Allocation Profile and support for amount).

We also argue that if the allocation basis is changed to the accumulation of cost centers 30110 and 30120 positive adjustments should be made as well as negative. This change would increase the FY 1985 allocation by $5,998 and the FY 1986 allocation by $2,175.

18 CC 23000 - Corporate Affairs: We believe the administrative functions performed in this cost center support our original allocation percentages. (Attached Cost Center Profile).

If the revised allocation approach remains in effect, it must be recalculated to incorporate any changes made to Cost Centers 23100, 30100, or 30110 as a result of our comments.

19 Cost Center 22000 - Legal: The finding eliminates all allocations to Medicare from the Legal Department. Historically, the Legal Department has not used standard allocation percentages; they have adjusted percentages monthly based on actual work performed.

Review of the audit workpapers in this particular case indicates that the auditors requested support for the August, 1986 CAID percentages for Medicare. Input documents were provided for each of the lawyers with an attached note that additional support was available in CHRON FILES available in the Legal Division. Apparently, no effort was made by the auditors to review the CHRON FILES. We assumed no problem existed since no additional documentation was requested and no adjustment was proposed to us during the most recent fieldwork or at the informal exit conference in April, 1990. It would have been much easier to find additional support during the original field review.

During recent review of the audit workpapers we also noticed that the Medicare allocation for one lawyer, L. Sheperd, was incorrectly carried forward to the summary calculation schedule. Her sheet indicated 15% Medicare A and 10% Medicare B. This summary sheet has been corrected and is attached. The revised average with this correction comes much closer to the actual allocation percentages used that month.

We believe that the original supporting documentation provided reasonbly supports the allocation to Medicare from the Legal Department. On that basis this finding should be passed.

MC83/b23-30

CONTRACTOR-OWNED AUTOMOBILE COSTS

This finding reduces claimed expenses for two separate reasons:

1 The auditors determined that the cost related to personal usage of automobiles exceeded the personal usage payments made by employees and offset the difference.

2 After the above adjustment the auditors compared remaining expenses (and applicable Return on Investment on the automobiles) to the applicable rate per the Federal Travel Regulations and disallowed cost in excess of that rate per mile.

Regarding Item #1 we continue to state the position noted in prior audit responses:

> The provision of a corporate auto for business use involves two elements of cost to the corporation. The first element is the fixed cost incurred by the act of acquiring the automobile and thus does not relate to usage other than that which originally justified provision of the automobile. The second is the variable cost relating to the amount of utilization of the auto for business and personal purposes.
>
> Since elimination of personal usage of the vehicles would not reduce the fixed costs, the corporation's practice has been to charge employees only for the variable cost associated with personal usage. FAR Section 31.205-46(f) clearly disallows the cost involved with personal usage of automobiles but does not specifically deal with the methodology for computing personal usage cost.

Regarding Item #2 we understand the requirement stated in Appendix B, Section XII, of the Medicare contract which limits allowable cost to the rate per mile in the Federal Travel Regulations. Our concern is with certain items included in our expenses for comparison to the allowed rate.

The Federal Travel Rate is designed for establishing reimbursement for government employees using their own cars. Appendix B, Section XII of the Medicare Agreement states:

> "The cost of automobiles includes the cost of depreciation, lease, maintenance, insurance, fuel, and other related costs. The reasonable cost of such automobiles which may be charged to this agreement/contract shall be the actual cost not to exceed the rate published in the Federal Travel Regulations, ..."

Based upon this section and our interpretation of the methodology used in developing the Federal Travel Rate, we believe only costs directly related to the automobiles should be included in any determination of allowable costs. The following items included in your calculation of the Federal Travel Rate limitation should be excluded for a proper offset:

1 Return on Investment calculated on the fleet vehicles; and

2 Expenses included in Cost Center 24200, Fleet Vehicle Services, related to managing the Fleet Vehicle program and not directly related to the automobiles themselves.

The Return on Investment is a return allowed for contractors for the investment of their funds in assets used in administering the Medicare program and not a travel or auto expense.

Exclusion of these items from the calculation of allowable automobile costs affects the total finding as follows:

	N 85		N 86	
	A	B	A	B
Adjustment Draft Report	$65,969	$43,079	$110,390	$92,973
Less Return on Investment	(16,704)	(15,051)	(36,048)	(36,048)
Less: CC24200 Admin. (See Attached)	(5,976)	(5,976)	(13,572)	(13,572)
Revised Adjustment	$43,289	$22,052	$ 60,770	$43,353

Our fleet vehicle program was eliminated December 31, 1986. Therefore major problems with automobile costs should not exist after that date.

MC84/b22-23

COST CENTER 24200

	FY 85	N 86
Total Cost Center Expense	$(17,367)	$1,109,763
Less: Accounts with Fleet Vehicle Expense		
72001 - Insurance	(9,007)	(135,830)
72204 - Owned Car Expense	(536,816)	(504,166)
72205 - Vehicle Chargeback	813,783	10,048
72206 - Chargeback Income	123,446	240,795
73301 - Depreciation	(323,093)	(609,184)
Net Cost - Fleet Vehicle Administration	$ 50,946	$ 111,426

	A	B	A	B
Medicare Share (W/P 4254)	11.73%	11.73%	12/18%	12.18%
Medicare Cost-Administration	$5,976	$5,976	$13,572	$13,572

MC84/b24

Claimed Costs Exceeding the Approved Budget

This finding identifies expenses included on the 1985 and 1986 FACP's that exceeded the approved budget for specific operations. These expenses had been included on the FACP's in *an* effort to document all expenses applicable to Medicare operations.

The attached schedules compare expenses included on the FACP's to the actual funding received from HCFA through the Administrative Draw process. These schedules clearly indicate that we did not draw funding for any of the expenses included in this adjustment. Since no funding was drawn, no repayment will be due to the Health Care Financing Administration as a result of this adjustment. We believe these facts should be noted in the report and that the summary be revised to note that this is not a dollar finding or adjustment.

Additionally we believe that the costs in excess of **NOBA** identified in this adjustment should be used to offset the effect of the other adjustments to these FACP's. We agree that Arkansas Implementation funding is limited to the HCFA approved amount. HCFA agreed to fund only a portion of the Arkansas System implementation with a specified additional productivity investment (PI) amount. The costs incurred in excess of the PI funding are allowable operating expenses for the Medicare A operation and valid replacement costs for other disallowed costs resulting from the FACP audit. The remaining $42,468 in N 1985 and $14,848 in FY 1986 should serve to substitute for other cost disallowances. We will explain this approach in more detail in a separate section of our response covering all Costs Incurred But Not Claimed.

Return on Investment Costs

We agree with the audit finding on this issue. Through 1985 a system generated process computed Medicare ROI on Equipment for inclusion in Interim Expenditure Reports and **FACP's.** We recognized in 1986 that this system had become obsolete but did not develop an alternative method.

We did prepare the calculation eventually used by the auditors for this finding and have a similar process in place for current reporting.

Complementary Insurance Credits

We respond to the individual findings here as follows:

1. Complementary Insurance Claims - We agree with the minor adjustments made to the claim counts used to determine the credit.

2. Comlementary Credit Rate Methodology - We agree that our calculated rate was not adjusted for actual N 1986 expenses. Our original rate calculation *was* based on FY 1987 budgeted cost *as* the best means of estimating a rate in mid-1986 when the manual change regarding the complementary credit rate became effective. We have recalculated our crossover rates based upon actual N 1986 claims processing expenses as follows :

Part A

The cost of a crossover claim should include actual and overhead costs directly attributable to producing an adjudicated claim record. The cost of transferring the crossover claim to another insurer should also be included in the unit cost calculation of a crossover claim. Some costs incurred by Medicare Operations are not involved in the claims processing function but are related to other functional processes related to our Medicare contract, such as provider and beneficiary corres-pondence, appeals, provider education.

Following is a summary of the FY 1986 cost centers and operations not related to claims adjudication which should be excluded from the expenses accumulated to calculate the crossover claim per unit charge. Attached is supporting documentat ion for the amounts identified.

Cost Center 33330 - Customer Service Center - $336

Cost Center 33100 - Consumer Division Operations - $4,219

Providing services to beneficiaries and providers in response to general inquiries , assistance and education is a claim payment function. The cost for the two cost centers above was Medicare's allocated cost for beneficiary walk-in service located at 120 W. Market Street, Indianapolis, Indiana. The service is to answer beneficiary and provider inquiries related to Medicare in general or specific Medicare claim payment issues. The cost incurred is in compliance with Health Care Financing Administration (HCFA) requirements to provide "walk-in" service and is not related to cost of producing an adjudicated claim record.

Cost Center 39100 - Government Relations (Senior Hoosier Liaison Program - SHLP) $2,262

The SHLP project was a special Medicare- beneficiary outreach and training program. This process *was* a special beneficiary relations function not related to any specific claims adjudication process and should be excluded from the cost of a crossover claim.

Cost Center 39250 - Provider and Beneficiary Assistance - $56,133

This cost center provides local and toll-free telephone inquiry service for Medicare providers and beneficiaries. No services or costs were incurred for any supplemental insurance carrier by this department and thus this cost should be excluded from the crossover claim cost calculation.

Cost Center 39215 - Adminsitrative Suport - $41,418

This unit prepared all operational reports required by the HCFA such as monthly claims workload, correspondence, workload, etc. Staff who responded to Congressional, Social Security Administration and written beneficiary inquiries were also charged to this cost center. These costs should not be included in the crossover claim cost calculation.

Cost Center 39300 - Government Programs - $24,961

The Government Programs Department is responsible for coordination and liaison activity with the HCFA. Activity involves coordination on HCFA inquiries and requests for information, fiscal budgets, and new program initiatives created by Legislation or new administration procedures. These activities are monitoring and coordinating in nature and do not relate to claim adjudication activities. These costs should be excluded from the crossover claim calculation.

Cost Center 39214 - Data Entry (Outside Professional Service) - $55,518

The cost of outside professional service was for a contract with Records Management, Inc. (RMI). Medicare A did not microfilm claims. We retained only a limited volume of hardcopy claim files. RMI performed storage and retrieval of claims needed as a result of adjustments or for appeal cases. This act is not related to the work effort and procedures necessary to produce an adjudicated claim record for the crossover claims process.

Review of Expense Accounts Charged to Claims Processing

Postage	$271,371
Materials and Supplies	92,718
Telephone	36,895
Total	$400,984

The above costs relate only to incremental costs other than claims adjudication expenses in cost centers not eliminated in full above. Postage expense was for the issuance of provider weekly payment listings and beneficiary Explanation of Medicare Benefits (EOMB's). During this period of time, Medicare did perform telephone development and also called providers to advise them of claim denials.

These processes were in compliance with HCFA procedures and were processes in addition to claims adjudication, which provided no benefit to a complementary insurance carrier. These costs should be excluded from the crossover claim cost calculation. The cost of materials and supplies were costs related to the batching, storage, shipment and/or retrieval of claims. Since the adjudicated claim file was an electronic record, we believe it is obvious the material and supply costs were incurred for other functional areas' operations and not a direct cost to be included in crossover claim costs.

Overhead Allocations to Medicare

Some services charged to the Medicare A Operations as corporate overhead are direct charges based upon a specific use rather than a shared cost based upon a cost accounting allocation base. The following costs should be excluded from the crossover claim cost calculation:

Cost Center 24534	Organization Effectiveness 6 Training (OE&T)	$ 17,770
Cost Center 31315	Outgoing Mail	22,640
Cost Center 31340	Forms - Graphics	29,927
Cost Center 31345	Records Center	11,575
Cost Center 31350	Micrographics	4,576
Return on Investment		39,881
Total		$126,369
% of Allocation to L-l		41.64%
Total Cost - L.1		$ 52,620

The costs incurred for cost centers 31340 and 31345 were cost related to the development of new forms and storage of these forms for the new Arkansas system. The forms are used for internal workflow processes such as batch control sheets, claims inquiry forms, pro forma report forms, etc. The Micrographics cost is for charges related to generation of Computer Output Microfilm (COM) filming of weekly payment listings used for inquiry research purposes.

The outgoing mail represents staff cost to mail Medicare A claims payments, i.e. manual stuffing, address labels to issue weekly Medicare A payments to providers. The cost of OE&T was for training and team building sessions for Medicare A management staff. The costs to Medicare A are not a part of the claim adjudication process to create an electronic transfer for crossover claims and should be excluded from the cost calculation. Return on Investment is a use/yield allowance based on undepreciated asset values and does not reflect a direct operational expense.

Finally, the calculation of the crossover charge used only the number of original claims processed (1,486,023). Claims adjustments were not included in this amount yet they are data entered and an adjudicated claims record which is a part of the functional costs included in Budget Line 1. The HCFA did not require a separate count or reporting of adjustment bills processed until April, 1986. Medicare A processed 1,381 adjustments. The work effort also does not reflect "delete" transactions. After a claim is entered into the processing system it was sometimes necessary to delete and return the claim to the provider since vital information was missing from the claim. Medicare A handled 97,461 delete transactions in N 1986. We believe the adjusted Line 1 cost should be divided by 1,585,045 to determine the average unit cost.

Part B

The cost of a crossover claim should include actual and overhead costs directly attributable to producing an adjudicated claim record. The cost of transferring the crossover claim to another insurer should also be included in the unit cost calculation of a crossover claim. Some costs incurred by Medicare Operations are not involved in the claims processing function but are related to other functional processes related to our Medicare contract such as postage, generation of Explanation of Medicare Benefits, etc.

Following is a summary of the cost centers and operations not related to claims adjudication which should be excluded from the expenses accumulated to calculate the crossover claim per unit charge. Attached is supporting document at ion for the amounts ident if ied.

Cost Center 39100 - Government Relations (Senior Hoosier Liaison Program - SHLP) - $37,596

The SHLP project was a special Medicare beneficiary outreach and training program. This process was a specific beneficiary relations function not related to any specific claims adjudication process and should be excluded from the cost of a crossover claim.

Cost Center 39300 - Government Programs - $49,838

The Government Programs Department is responsible for coordination and liaison activity with the HCFA. Activity involves coordination on HCFA inquiries and requests for information, fiscal budgets, and new program initiatives created by legislation or new administrative procedures. These activities are monitoring and coordinating in nature and do not relate to claims adjudication activities. These costs should be excluded from the crossover claim calculation.

Cost Center 39224 - Technical Services - $409,183

The Technical Services staff consisted of systems and technical research persons dedicated to implement HCFA regulatory changes and/or administrative changes. A major effort was the annual pricing update as well as ongoing pricing review and analysis. This staff was involved in the design, testing, and implementation of system changes. The services performed are to the claims system, however, the resulting changes are for the benefit and compliance of the Medicare program only.

Cost Center 39225 - Process Control (Material & Supplies) - $73,124

The Process Control Unit was responsible for the opening, sorting and batching of hardcopy claim receipts as well as control of claim files retained in the processing area. The material and supplies costs incurred in this cost center were for files and forms to batch and control claims as well as the cost of retrieval of microfilm copies for claims adjudication purposes. This process is not a cost of claims adjudication required or related to a crossover claim but a feature of our operation which enhanced our operational efficiency.

Review of Expense Accounts Charged to Claims Processing

Postage	$ 984,272
Telephone	42,431
Travel	7,992
Total	$ 1,034,695

The above costs relate only to incremental costs other than claims adjudication expenses in cost centers not eliminated in full above. Postage expense was for the issuance of provider weekly payment listings and beneficiary Explanation of Medicare Benefits (EOMB's). These costs should be excluded from the crossover claim cost calculation.

Overhead Allocations to Medicare

Some services charged to the Medicare Operations as corporate overhead are direct charges based upon a specific use rather than a shared cost based upon a cost accounting allocation base. The following costs should be excluded from the crossover claim cost calculation:

Cost Center 24534	Organization Ef fect iveness 6 Training (OE&T)	$ 25,497
Cost Center 26001	Taxes	175,110
Cost Center 31315	Outgoing Mail	81,951
Cost Center 31340	Forms - Graphics	57,075
Cost Center 31345	Records Center	22,083
Cost Center 31350	Micrographics	44.091
Total		$ 405,807
Percent of Allocation to Line 1		67.07%
Total Cost - Line 1		$ 272,175

The costs incurred for cost centers 31340 and 31345 were cost related to the development of new forms and storage of these forms for the new Medicare B system. The forms are used for internal workflow processes such as batch control sheets, claims inquiry forms, pro forma report forms, etc. The micrographics cost is for charges related to generation of microfilming of claims and payment listings used for inquiry research purposes. The outgoing mail represents staff cost to mail Medicare B claims payments, i.e. manual stuffing, address labels to issue Medicare B payments to providers and beneficiaries. The cost of OE&T was for training and team building sessions for Medicare B management staff. The costs charged to Medicare B are not a part of the claims adjudication process to create an electronic transfer for crossover claims and should be excluded from the cost calculation. Though, in theory, these costs should be excluded, in FY 1986 the total overhead allocation was already eliminated in our application of the fixed price limitation on claims operations cost. For FY 1986 we will not reduce total expenses by any amount for overhead.

Finally, the calculation of the crossover charge used only the number of original claims processed (5,454,586). Claim adjustments were not included in this count yet they are data entered and are an adjudicated claim record which is a part of the functional costs included in Budget Line 1.

The Carrier Appeal Report, HCFA Form 2590, reflects 446,020 appeal case adjustments and claim reopenings and revisions. This workload should be used in determining the unit cost. The cost should be divided by 5,900,606 to determine the average unit cost for a crossover claim.

We have recalculated the crossover rates for both Part A and Part B to take into account the exclusions explained previously. (See attached.) These computations and the narrative information presented in support do clearly show that the budgeted rate used during N 1986 for Part A and Part B *was* reasonably developed.

Part A

Crossover Rate Recalculation

Processing Cost per FACP			$ 2,747,461
Plus: Crossover Credit			188,440
Subtotal			2,935,901
Less: Inquiry Cost			(4,555)
C.C. 39100 (Sr. Hoosier Liaison Program)			(2,262)
C.C. 39250 (Prov. 6 Bene. Assistance)			(56,133)
C.C. 39215 (Admin. Support)			(41,418)
C.C. 39300 (Govt. Programs)			(24,961)
C.C. 39214 (Data Entry)			(55,518)
Excluded Expense Accounts			(400,984)
Specific Overhead Allocations			(52.620)
Net Cost - Claims Processing			$ 2,297,450
Claims Processed:			
	Claims Proc. per FACP	1,486,023	
	Deletes	97,641	
	Adjustments	1,381	
Total Processed			1,585,045
Cost per Claim			$1.45
Crossover Rate $\frac{(1.45)}{(2)}$			$ .72

Budgeted Rate Used in N 1986 = $.74

FACPa11

Part B

Crossover Rate Recalculation

Processing Cost per FACP		$ 7,689,863
Plus: Crossover Credit		956,323
Subtotal		8,646,186
Less:		
C.C. 39100 (Sr. Hoosier Liaison Program)		(37,596)
C.C. 39300 (Govt. Programs)		(49,838)
C.C. 39224 (Technical Services)		(409,183)
C.C. 39225 (Process Control)		(73,124)
Excluded Expense Accounts		(1,034,695)
Specific Overhead Allocations		0
Net Cost - Claims Processing		$ 7,041,750
Claims Processed:		
Claims Proc. per FACP	5,454,586	
Adjustments and Reopenings	446,020	
Total Processed		5,900,606
Cost per Claim		$1.19
Crossover Rate $\left(\frac{1.19}{2}\right)$		$ .60

Budgeted Rate Used in N 1986 = $.66

FACPb14

Taxes

This finding involves three different issues regarding the allocation of taxes to Medicare. Our individual responses are as follows:

1. Indiana Gross Income Tax - We accept this finding. We have subsequently begun computing applicable IGIT ourselves which should improve our accuracy.

2. Personal Property Taxes - We accept this finding. Personal property taxes were located in the Taxes Cost Center effective January 1, 1986 which should have provided for more accurate allocations to Medicare. The problem was an error in the approach used to develop the allocation basis for this account that went undetected.

3. Deferred Taxes - Again this tax account was moved to the Taxes Cost Center effective January 1, 1986. Review of accounting records after that date prove that we successfully stopped all allocations to Medicare. The allocations identified during the audit occurred during Calendar Year 1985. We found Cost Center Profiles for the cost centers in which deferred taxes were located that indicated this account should not be allocated to Government. We made an undetected clerical error on the Cost Allocation Input Document that caused the incorrect allocation to Medicare. We accept this finding.

al

Cost Claimed in Error

Several individual adjustments were made under this caption. Our response to each is as follows:

1. EDS Accrual Reversal - The $85,839 adjustment here was accrued as an expense in N 1984 and identified as an error as part of the 1984 FACP audit. The auditors found that $85,839 of the accrual had never been reversed. The adjustment to reverse the accrual is a FY 1985 finding which we accept.

2. Compensated Absences - We had made an adjustment to the N 1985 Part B FACP to adjust the compensated absence year end accrual but had not made the Part A calculation. This adjustment established the necessary Part A cost reduction as $8,492.

   My understanding of this denial and the adjustment we made to reduce N 1985 Part B costs is that these accruals would be reversed in FY 1986, and thus added back to N 1986 FACP total expenses. At our exit conference we, I believe, also agreed that these amounts should be added back in FY 1986.

   In summary, this adjustment should be modified to reflect additions to claimed N 1986 expenses as follows:

Part A	$8,492
Part B	$4,297

3. Photocopy Chargeback - We agree with this finding.

4. Rent Variance - We accept the $10,300 reduction to FY 1985 Part B costs as a result of this finding and the corresponding increase in FY 1986 costs.

5. Employee Cost Center Changes (Manual Adjustments) - This finding involves the correction of some manual adjustments we had made to complete our N 1985 **FACP's.**

   Your workpaper Section 2104 includes workpapers we prepared to develop our manual adjustments with the additional changes you considered appropriate. Cur concern now is the treatment of the one employee, B. Cooley. His salary and benefits were included on this schedule but not made a part of our adjustment to exclude certain salaries from the Medicare FACP. In addition to other minor reclaculations your adjustment did pull out most of B. Cooley's salary and benefits.

   I discussed Mr. Cooley's status with Steve Crickmore, then Director of Part A Claims, and received the following response:

"Indiana was a very slow starter in receiving EMC claims in Medicare A. Since Bob Cooley was the only education consultant who had worked with EMC, he was retained to help in increasing the Medicare A EMC volume. HCFA provided Productivity Investment (PI) money for EMC during N 1985 and 1986. Sharon Muncie and Wendy Gehlbach were transferred to private business due to the budget problems at that time, however, the EMC PI money enabled us to keep B. Cooley. HCFA put an extreme amount of pressure on us to make significant improvements in our EMC volume."

Mr. Cooley was an employee of Medicare A until his recent resignation.

This information explains why we did not include B. Cooley in our manual FACP adjustment and why that part of your finding should be reversed. Removal of this part of your finding will modify your adjustment as follows:

N 1985, Part A:	$15,328 Increase
N 1985, Part B:	$(3,876) Decrease

ADVERTISING AND PROMOTIONAL COSTS

Our response to the individual findings making up this category are as follows:

1 Sales Awards - We accept this finding.

2 Nat ional Advert ising - This adjustment summarizes the review of several advert ising general ledger accounts. Audi t workpapers indicate denial of total costs allocated to Medicare through these accounts with little or no review of individual invoices.

More detailed review of Account 70104 - Newspaper Advertising reveals that Medicare allocations come from Cost Center 32300 - Paper1 ess Cl aims (See Attached). During the audit period HCFA funded Electronic Media Claims as a Productivity Investment in an effort to substantially increase the number of Medicare claims received electronically. Cost Center 32300 was charged with that responsibility. Newspaper Advert is ing expense incurred in this cost center would logically be involved with the EMC project, thus a reasonable al location to Medicare would be allowable. Passing this portion of the finding would reduce your FY 1986 adjustment by $581 for Part A and $1,211 for Part B.

Regarding Account 70808, Nat ional Advert ising we accept the finding. Our system provides the capability to special allocate individual accounts within a cost center. The intent was to use this feature to keep national advert ising out of Medicare expense al locations, but apparently we were unsuccessful in this instance. The attached page does indicate, however, that we did stop the al location of this account to Government in Calendar Year 1986.

3 Promotional Costs - This adjustment reflects the denial of all expenses charged to Medicare through Account 70201, Public Affairs. Most of this expense relates to our sponsorship of an event called "A Celebration of Health and Fitness, a statewide event designed to encourage healthy 1 ifestyles. This expense was located in a cost center that makes a small al location to Medicare.

Our opinion is that our sponsorship of this event is a community service program reasonably allocable to Medicare based on FAR Section 31.205-1(e)(3). Allowing this expense item would reduce your FY 1986 adjustment by $14,343 each for Part A and Part B.

MC84/b27

Professional and Consulting Costs

Our responses to the individual findings included in this grouping are as follows:

1. Auditing Consulting Fees: Detailed review of invoices charged to this account identified a few non-Medicare consulting invoices located in Staff and Support cost centers that allocate a portion of their total cost to Medicare. We accept the adjustment but do not consider this a significant internal control weakness. The cost centers involved here all allocate from 3% to 6% of their cost to Medicare. Allocation bases are not set up to deal with every individual invoice. Certain specific invoices could be under-allocated to Medicare just as easily.

2. Medical Consulting - We accept the adjustment which represents the Medicare share of one improperly coded invoice.

3. Merger Committee Meeting - We accept this very small adjustment.

4. Actuarial Consulting - We accept this small denial which represents the Medicare allocation of two payments to our pension actuary for review of documents for a non-Medicare subsidiary.

5. National Accounts Review - We accept this finding.

6. Consulting - Other (Acct. 75803) - We accept this finding.

7. Outside Legal Services (Acct. 75001) - Based upon a review of individual invoices charged to this account the auditors computed a percentage of total costs that were non-allowable for Medicare (in their opinion). They applied this percentage to Medicare allocated cost through this account to compute the Medicare denial. Since different issues are involved, we will respond for each fiscal year individually.

   A. N 1985 - All Medicare charges from this account came through Cost Center 22000, Legal Division. The specific invoices considered non-allocable to Medicare involved services provided in connection with the merger of Blue Cross and Blue Shield.

      We accept this finding but do suggest one technical correction to the adjustment. On Workpaper 4051 1/1, two items considered non-allowable appear allowable based on the information included on the workpaper. These items are March, 1985 and May, 1985 payments to Roberts & Rydel totalling $3,141.40. Treating these as allowable would reduce your N 1985 adjustments by $270.

      We also note that another of your findings totally denies Medicare allocations from the Legal Division. Depending on the final disposition of that finding, this adjustment could be a duplication in total.

B. N 1986 - The adjustment here primarily relates to damages and attorney fees paid as part of the settlement of a discrimination law suit by several former employees. These payments were expensed in a cost center that does make a small allocation to Medicare.

We do accept this finding but as a one-time occurrence and not as a sign of poor internal controls.

Gains and Losses on the Sale of Depreciable Property

We agree that an appropriate share of gains or losses on disposal of depreciable assets should be allocated to the Medicare Program. We also agree that this allocation was not made on the submitted FACP's.

We do, however, question the amount of the adjustment for both fiscal years. The auditors took the balance in Account 62102 (Loss & Gain on Sale - Fixed Assets) for each fiscal year and applied an overall Medicare percentage to compute the adjustment. We reviewed individual month's journal entries to this account and noted a mismatching of revenues from these sales and the corresponding write-off of the net book value of the items sold.

The attached schedules clearly show that entries were made in November, 1985 to Account 62102 to write-off the remaining value of assets sold prior to September 30, 1985. Obviously our goal was to make this account accurate at December 31, our corporate year end, rather than at the end of the Medicare fiscal year. Review of the journal entries alone would indicate that the same kind of cumulative write-off occurred in November, 1986.

We believe that your adjustment should be modified as follows to use more accurate balances for the 62102 Gain or Loss Account:

	N 9/30/85	N 9/30/86
Account 62102 Balance at 9/30 (Your W/P 3500 1/2)	$ 487,046	$(113,373)
11/30/85 Write-offs (Appl. to N 9/30/85)	(500,760)	500,760
11/30/86 Write-offs (Appl. to N 9/30/86)	---	(478,580)
Adjusted Account Balance	$ (13,714)	$ (91,193)

(Loss)

This correction to the account balance would change your finding to the following:

	Revised Balance	Alloc. %	FACP Expense Increase
N 1985 A	$ (13,714)	5.40%	$ 741
N 1985 B	$ (13,714)	3.11%	$ 427
N 1986 A	$ (91,193)	5.35%	$4,879
FY 1986 B	$ (91,193)	2.97%	$2,708

As noted above, attached is detailed support for the N 1985 retirements made in November, 1985.

OTHER UNALLOWABLE COSTS

This category is again made up of several individual findings. Our responses to these findings are as follows:

1 Travel and Entertainment - For entertainment the auditors identified all costs charged to Medicare through two entertainment subaccounts and denied the total. We accept this finding.

Travel denials were based on a review of a sample of invoices charged to travel accounts. We also accept the relatively small adjustments here.

We do note that of the Entertainment denial approximately $519 of the total adjustment relates to expenses allocated to Medicare through Cost Center 23100. In your report the entire allocation of this cost center to Medicare has been denied. We have disputed this finding elsewhere in our response, but if the entire cost center remains a denial, this finding should be revised to avoid a duplicate adjustment to Medicare cost.

2 Blue Cross Association Wire System Costs - we accept this finding.

3 Relocation Expense - We accept this finding.

4 Contributions - We accept the finding and agree that contributions should be excluded from Medicare expenses. The immaterial adjustment here indicates no major problem with our controls.

5 Financial Costs - The cost denied here represents the Medicare share of Interest Expense accrued on Deferred Compensation for members of the Board of Directors. We agree that this account should not have been allocated to Medicare.

We do note that for FY 1986 $1,158 of the Medicare A and B allocation to this account comes from Cost Center 10002. Since in another finding you reduced the Medicare allocation percentage for this cost center, a minor part of your adjustment here is a duplication.

	FY 1986	
Total Account 74903 in CC 10002	$17,404.03	(G/L)
% Used for FACP	6.66%	
Medicare Allocation A & B	$ 1,159.00	
Your Revised Allocation (5.55%)	(966.00)	
Duplicated Adjustment (A & B each)	$ 193.00	

6 Outside Printing - The two invoices in question total to $9,347.42 and were processed in November, 1985. Review of the attached G/L summary for Cost Center 31340 demonstrates that this expense was taken back out of Cost Center 31340 in December, 1985. Since this expense was backed out of total expense, this adjustment should be passed. Perhaps this fact explains why our notes indicate that the auditors passed further review of these invoices.

7 Settlement Expense - The settlement of a law suit by several former employees resulted in the payment of Back Pay to those employees. This payment was included in a cost center which makes an allocation of cost to Medicare A. We accept the elimination of this unintentional allocation.

State Insurance Commissioner's Costs

This finding denies in total the Medicare allocated share of the expenses incurred for the State Insurance Commissioner's annual audit.

In our opinion this is an allowable expense that can be reasonably allocated to our Medicare contract. An audit by the State Insurance Commissioner is required for insurance companies and is thus a routine cost of doing business. Since Medicare contractors are primarily insurance companies, the prohibition against non-Medicare cost in Appendix B, Section XV, is not appropriate here. Additionally, our understanding is that this issue has been debated in previous FACP audits at other sites with a final determination that this expense is an allowable Medicare allocation.

We also note that our focus of this audit is the adequacy of reserves and thus the solvency of the insurance company. It would appear that contractor solvency does have a least a general application to the Medicare program.

In summary, we believe that the cost of this audit is an administrative cost that is reasonably allocable to Medicare. The relatively small share of this cost allocated to Medicare on our FACP's should be accepted and your finding reversed.

Cost Incurred But Not Claimed/Replacement Cost

For both FY 1985 and N 1986 we incurred expenses that were not fully reimbursed by HCFA. In the following section, we will identify those expenses and document how they serve to replace other expense disallowances made through your adjustments. Once we reach final disposition on the proposed adjustments, we can use the items and methodologies identified here to reach the final amount reimbursable to HCFA to settle these audits.

1. N 1985 - We have several areas of unreimbursed costs which are explained as follows:

   A. For Part A, we incurred $329,361 of expense for the Arkansas Implementation. Only the $225,000 HCFA had provided for this project was reimbursed to us. Thus any adjustments made to the Arkansas Implementation would be replaceable up to the $104,361 overspent.

   The first item to note here is pension cost. Per your audit work-papers, $5,000 of the Medicare A pension expense denied came from the 050220 Implementation Recipient Code. This $5,000 should be backed out of your adjustment.

   Additionally $91,697 of expense was charged to this project that was not included as System Implementation in the cost system (see attached). This cost relates to personnel working on the implementation for whom manual adjustments were made to properly allocate cost to the system implementation. We made these additional allocations even though total costs charged exceeded HCFA funding. We have no precise way to specifically identify the pension component of these allocations outside the system. We can estimate the pension included in this expense through developing an overall percent of pension to total Personal Service Cost. For N 1985 we estimate this percentage as 7.9%. Based upon this information we believe your Pension Expense adjustment should be further reduced as follows:

Part A Expense Allocation to Implementation	$ 91,697
Pension %	7.9%
Reduction to Pension Adjustment	$ 7,257

   B. On the Part A FACP, we reported expenses that exceeded the NOBA by $143,851. Backing out the system implementation variance reduces this excess expense to $39,490. This total is the net variance resulting from differences on several operations.

   Since this expense has not been reimbursed by HCFA, we believe the $39,490 should serve as a direct reduction of the FY 1985 Part A adjustments you have identified. Your adjustments clearly reduce Part A expenses well below the NOBA, thus these excess expenses we incurred and originally reported now become reimbursable.

C. On Part B for N 1985 we incurred $2,978 of expense over our NOBA allowance on the Physician Fee Freeze operation. Since the total effect of the Part B adjustments would clearly reduce Fee Freeze cost below the NOBA allowance, the $2,978, which was never reimbursed by HCFA, serves as replacement cost for expenses you have denied.

In summary, this analysis documents FY 1985 replacement costs totalling $51,747 for Part A and $2,978 for Part B.

2. FY 1986 - For this fiscal year we have several of the same replacement cost options as FY 1985 with one major addition. For FY 1986 we agreed with HCFA on a contract amendment which limited our potential funding for both Part A and Part B on the workload based operations (Part A, Lines l-2; Part B, Lines l-3). During N 1986 we reported expenses at the contracted targets though actual expenses significantly exceeded those targets. Excess expenses incurred here serve, in effect, as replacement costs which offset that portion of your adjustments applicable to the workload lines.

In the following analysis we will identify items of replacement cost and explain our methodology for calculating applicable replacement cost:

A. The Arkansas Implementation project continued during N 1986 with no funding from HCFA. In FY 1986 we incurred $617,757 of unreimbursed expense on this project. As in N 1985, an element of pension expense is included here. Since pension expense included in Arkansas Implementation cost was, in effect, self denied, any pension expense in the total expense should be backed out of your adjustment.

Your audit workpapers document $25,100 of N 1986 pension expense charged to recipient code 050220 (Arkansas Implementation). Of the $24,468 in expense charged to the implementation outside the cost system (see attached), another $1,923 is estimated as pension expense for a total of $27,023. This amount should be treated as a reduction to your N 1986 Part A pension adjustment.

B. Our 1986 Part A FACP included total expenses $10,469 in excess of the N 1986 Notice of Budget Approval (NOBA). This amount is further broken down as follows:

Lines l-2 (Fixed Price)	$ 73,935
Other Lines	(63,466)
Total Excess	$ 10.469

N 1986 was the first year of our supplemental fixed price contract with HCFA. Under this agreement total reimbursement for Claims Operations (Lines 1 and 2) was capped at $2.00 per claim processed for the first 1,393,000 claims and 75% of that rate or $1.50 for any additional claims processed. For the 1,483,023 claims we processed in FY 1986 applying these rates would produce a net cap of $2,925,535, exactly the cost we claimed for Lines l-2. The amount in excess of the NOBA on the claims lines was justified by higher claims volumes and is to be reimbursed through the FACP audit settlement.

Since our reimbursement through the Administrative Draw process was exactly the NOBA total, the additional $10,469 should be reimbursed now as part of the final settlement of the FACP.

C. On the FY 1986 Part B FACP total costs claimed exceeded the NOBA by $4,379. This excess occurred on one line, COBRA Participating Physicians. Since we limited our Administrative Draw to the total on the NOBA, we never received reimbursement for this extra cost.

Additionally since the share of your N 1986 Part B adjustments allocable to this operation would clearly exceed the $4,379, we believe that this amount serves as replacement cost to reduce the effect of your adjustments.

D. As noted previously, for N 1986 we were under the fixed price supplemental contract for Part A and Part B. This agreement established a ceiling on our expenses for the Claims Operations (Part A, Lines l-2; Part B, Lines l-3). On the FACP's we reported only expenses to the ceiling and thus had substantial unreimbursed expenses as detailed below:

	Total Exp.	Reported on FACP	Unreimbursed
Part A (Lines l-2)	$ 3,236,873	$ 2,925,535	$ 311,338
Part B (Lines l-3)	$11,487,487	$ 9,528,232	$ 1,959,255

Clearly these unreimbursed expenses serve as replacement cost for that portion of your N 1986 adjustments that applies to the Claims Operations.

We believe the following methodology will reasonably determine the percentage of your adjustments that should be charged to Claims Operations for comparison to the replacement costs identified above.

With only a few exceptions the adjustments you have made were to staff and support cost centers. Based on this fact it seems unnecessary to compute the line by line effect of each adjustment to identify the total effect of your adjustments to the Claims Lines. We propose the following:

(1) Part B

a. Complementary Coverage Adjustment - Any adjustment not disposed of should be charged 100% to Line 1 since this is a Line 1 function.

b. All Other Adjustments - Attached is a summary of total Part B costs incurred in N 1986 by Medicare Operations. From that schedule the following calculation can be made:

Total Costs (Lines l-3)	$ 11,487,487
Total Costs (All Lines)	14,200,182
Percent to Total (Lines l-3)	80.90%

On this basis 80.9% of remaining adjustments other than Complementary *Coverage* should be applied against the replacement costs up to the total cost that was unreimbursed.

(2) Part A

a. Complementary Coverage Adjustment - Again, any adjustment not disposed of should be charged 100% to Line 1 since this is a Line 1 function.

b. All Other Adjustments - Attached is a summary of total Part A costs incurred in FY 1986 by Medicare Operations. This schedule includes $617,757 for the Arkansas Implementation that was not claimed on the N 1986 FACP. Since only the pension adjustment materially affects implementation costs and we have dealt with modifying your pension adjustment separately, the implementation cost should be backed out in developing a percentage of total costs charged to Claims. With that correction the following calculation can be made for Part A:

Total Costs (Lines l-2)	$ 3,236,873
Total Costs (All Lines - Implementation)	$ 7,505,907
Percent to Total (Lines l-2)	43.12%

Using this approach, 43.12% of ***remaining*** adjustments other than Complementary Coverage should be applied against the replacement costs up to the total cost that was unreimbursed.

APPENDIX B

Ma-rch 18, 1991

Cathy,

Attached are schedules documenting the name of cost center 10003 and the total expenses charged to the cost center in FY 1985,

You are correct that the title is Executive Assistant - Office of the Presidents. In our response, I picked up the description of the duties of the cost center from Roger's workpaper rather than the cost center name.

Since the Blue Shield Executive resided in cost center 10000 in 1985 the number system would support that cost center 10003 served the Blue Shield Executive (as noted in the Dee'cription of Functional Duties on the audit workpaper). Attached is a Cost Allocation Profile for cost center 10003 which also supports the functional duties of the cost center.

Further review since your call has indicated that the allocation basis for this cost center was equal to the five markets. Since this cost center reported to the Blue Shield Executive and had the assignment to be a liaison with professional providers, no allocation was made to Part A. The total Government allocation was divided between Medicare Part B and Medicaid.

With this latest information we believe that the FY 1985 Medicare B allocation was correct as stated. The allocation profile *reflects* nc involvement of this cost center in investments, thus the. five marker approach is reasonable.

We are still working on additional actual documentation for the capitalized Forms/Graphics cost center.

Dennis W. Brinker

Dennis Brinker

APPROVAL

COST ALLOCATION PROFILE

Financial Analyst Deborah Benson

Date 1/15/85

SECTION 1 - Identification

Cost Center Code 10005

Approval

Cost Center Name Exec. Assistant - Office of President

Signature Herb Dixon

SECTION 2 - Description of functional duties:

Executive assistant to Blue Shield Executive. Acts as liaison to the professional providers.

SECTION 3 - Description of cost allocation basis and preparation of cost allocation input document including mathematical calculations:

Allocate equally to the five markets, then to segment and product as indicated by the market. Blue Shield and joint products only.

SECTION 4 - Expense Account Direct Allocation and Exception Allocation (if needed).

	Expense Account Number	Expense Account Name	Recipient Code for Direct Allocation or Exception Allocation Description
1.			
2.			
a.			
4.			
5.			
6.			
7.			
8.			

CENTER=0010002

OBS	ACCOUNT	OCT84	NOV84	DEC84	JAN85	FEB85	MAR85	APR85	MAY85	JUN85	JUL85	AUG85	SEP85
104	0074902	0.00	0.00	0.00	0.00	0.00	0.00	241.45	0.00	0.00	0.00	0.00	0.00
105	0074902	15.67	152.50	193.95	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
106	0075002	0.00	0.00	0.00	0.00	0.00	0.00	243.00	0.00	0.00	0.00	0.00	0.00
CENTER		13,065.67	634.50	1,984.45	0.00	10,391.00	0.00	484.65	850.00	2,000.00	0.00	0.00	0.00

CENTER=0010003

OBS	ACCOUNT	OCT84	NOV84	DEC84	JAN85	FEB85	MAR85	APR85	MAY85	JUN85	JUL85	AUG85	SEP85
107	0071001	0.00	0.00	0.00	6,856.00	6,856.00	6,856.00	6,856.00	6,856.00	6,856.00	6,856.00	6,856.00	6,856.00
108	0071001	6,856.00	6,856.00	6,920.85	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
109	0071099	0.00	0.00	259.40	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
110	0071401	0.00	0.00	0.00	170.00	170.00	170.00	170.00	170.00	170.00	170.00	170.00	170.00
111	0071401	185.00	185.00	185.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
112	0071402	0.00	0.00	0.00	610.18	610.18	610.18	610.18	610.18	610.18	610.18	610.18	610.18
113	0071402	630.76	630.76	630.76	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
114	0072101	0.00	0.00	0.00	1,322.13	106.85	401.19	0.00	0.00	0.00	0.00	108.65	890.82
115	0072101	402.62	264.94	223.25	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
116	0072102	0.00	0.00	0.00	0.00	422.00	164.00	0.00	0.00	0.00	0.00	0.00	0.00
117	0072102	40.00	0.00	704.90	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
118	0072103	0.00	0.00	0.00	52.12	62.50	0.00	0.00	0.00	0.00	0.00	76.50	58.00
119	0072103	0.00	0.00	77.05	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
120	0072104	0.00	0.00	0.00	290.00	0.00	0.00	0.00	50.00	0.00	0.00	0.00	0.00
121	0072104	0.00	0.00	50.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
122	0072105	0.00	0.00	0.00	400.42	133.57	150.36	0.00	0.00	0.00	0.00	24.50	55.76
123	0072105	71.95	0.00	37.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
124	0072106	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	10.00
125	0072203	0.00	0.00	0.00	30.00	2.50	0.00	0.00	0.00	0.00	4.25	0.00	0.00
126	0072203	30.00	30.00	30.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
127	0072204	0.00	0.00	0.00	0.00	30.00	30.00	30.00	30.00	0.00	60.00	30.00	30.00
128	0072205	0.00	0.00	0.00	565.01	569.40	491.16	455.00	0.00	945.33	516.16	425.00	447.50
129	0072205	0.00	613.95	637.19	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
130	0072301	0.00	0.00	0.00	0.00	0.00	374.18	477.44	1,033.19	104.10	29.57	400.23	-80.25
131	0072301	601.87	207.67	80.60	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
132	0072302	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	390.00	0.00	0.00	0.00
133	0072302	822.00	274.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
134	0072303	0.08	0.00	0.00	0.00	0.00	0.00	0.00	70.25	58.00	1.25	0.00	-58.00
135	0072303	115.25	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
136	0072305	0.00	0.00	0.00	11.83	28.95	13.16	0.00	650.74	84.59	16.03	119.88	-41.01
137	0072306	275.14	200.53	420.14	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
138	0072306	8.00	0.00	0.00	0.00	20.00	0.00	0.00	0.00	0.50	0.50	0.00	0.50
139	0072306	0.50	66.75	6.80	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
140	0072401	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	65.55	0.00	0.00	0.00
141	0072406	0.00	0.00	0.00	53.00	53.00	53.00	53.00	53.00	53.00	53.00	53.00	53.00
142	0072406	50.00	50.00	50.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
143	0073301	0.00	0.00	0.00	8.43	8.40	8.43	8.40	8.43	8.40	8.43	8.40	8.43
144	0073301	8.40	8.42	8.40	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
145	0074101	0.00	0.00	0.00	390.71	0.00	0.00	19.50	0.00	0.00	0.00	0.00	44.10
146	0074101	0.00	39.22	15.17	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
147	0074102	0.00	0.00	0.00	0.00	0.00	0.00	51.91	0.00	19.87	0.00	0.00	0.00
14[illegible]	[illegible]	[illegible] 43	0.0[illegible]	0[illegible]		0	.00	0.[illegible]	[illegible]		[illegible]	[illegible]	[illegible]

CENTER=0010003

OBS	ACCOUNT	OCT84	NOV84	DEC84	JAN85	FEB85	MAR85	APR85	MAY85	JUN85	JUL85	AUG85	SEP85
149	0074106	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	72.51
150	0074107	0.00	0.00	0.00	2.01	1.68	6.63	41.58	30.58	4.80	3.27	4.17	15.99
151	0074107	0.18	0.42	4.23	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
152	0074111	0.00	0.00	0.00	0.00	0.00	0.00	7.79	0.00	2.98	0.00	0.00	0.00
153	0074111	0.64	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
154	0074114	0.00	0.00	0.00	1.44	37.12	0.00	0.00	1.65	0.00	0.00	0.00	0.00
155	0074116	0.00	0.00	0.00	0.00	2.16	2.16	0.00	0.00	0.00	0.00	0.00	0.00
156	0074201	0.00	0.00	0.00	25.05	18.90	0.00	38.85	78.75	31.50	0.00	16.80	0.00
157	0074201	234.15	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
158	0074402	0.00	0.00	0.00	18.50	18.50	0.00	0.00	0.00	0.00	0.00	0.00	0.00
159	0074403	0.00	0.00	0.00	3.17	4.92	0.23	0.40	6.13	0.78	0.77	0.81	2.15
160	0074403	2.42	1.29	2.59	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
161	0074604	0.00	0.00	0.00	186.35	157.37	130.87	131.24	112.93	132.08	121.46	106.37	185.90
162	0074604	172.69	212.38	183.69	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
163	0076401	0.00	0.00	0.00	627.30	486.38	483.34	483.34	483.34	375.10	0.00	0.00	0.00
164	0078901	0.00	0.00	0.00	0.00	0.00	0.00	0.00	18.15	0.00	0.00	0.00	0.00
165	0078901	0.00	0.00	54.45	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TOTAL	CENTER	10,505.00	9,641.33	10,551.47	11,623.65	9,800.38	9,944.89	9,434.63	10,271.52	9,912.76	8,450.87	9,010.49	9,331.66

10003   9800.38

118,478.65
117,778.65

CENTER=0020000

OBS	ACCOUNT	OCT84	NOV84	DEC84	JAN85	FEB85	MAR85	APR85	MAY85	JUN85	JUL85	AUG85	SEP85
166	0070804	0.00	0.00	0.00	250.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
167	0071001	0.00	0.00	0.00	27,492.00	27,492.00	27,492.00	27,588.00	27,588.00	27,588.00	27,588.00	27,588.00	27,588.00
168	0071001	24,920.00	24,920.00	25,118.69	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
169	0071004	0.00	11.41	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
170	0071006	0.00	7.13	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
171	0071099	0.00	0.00	3,923.08	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
172	0071401	0.00	0.00	0.00	510.00	510.00	595.00	510.00	510.00	510.00	510.00	510.00	510.00
173	0071401	555.00	558.90	555.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
174	0071402	0.00	0.00	0.00	2,446.80	2,446.80	2,503.60	2,455.34	2,455.34	2,455.34	2,455.34	2,455.34	2,455.34
175	0071402	2,292.64	2,294.30	2,292.64	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
176	0072101	0.00	0.00	0.00	54.50	38.08	0.00	73.00	15.00	92.90	28.00	54.00	18.00
177	0072101	354.51	24.75	335.28	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
178	0072102	0.00	825.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
179	0072103	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	2.00	0.00	0.00
180	0072103	10.00	49.40	1.50	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
181	0072104	0.00	0.00	0.00	0.00	0.00	150.00	0.00	0.00	0.00	0.00	0.00	0.00
182	0072104	18.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
183	0072106	0.00	0.00	0.00	90.00	0.00	0.00	0.00	0.00	180.00	0.00	0.00	0.00
184	0072106	0.00	300.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
185	0072203	0.00	0.00	0.00	60.00	0.00	0.00	0.00	0.00	0.00	0.00	0.75	0.00
186	0072203	60.00	60.00	60.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
187	0072204	0.00	0.00	0.00	30.00	37.50	30.00	55.60	30.00	0.00	60.00	30.00	30.00
188	0072204	-11.00	30.00	30.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
189	0072205	0.00	0.00	0.00	775.85	907.07	656.41	683.70	0.00	1,279.88	773.50	633.60	637.29
190	0072205	0.00	1,293.32	993.74	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
191	0072301	0.00	0.00	0.00	468.19	162.07	1,146.52	370.60	0.00	196.64	246.78	218.05	0.00
192	0072301	75.78	139.39	103.28	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
193	0072307	0.00	0.00	0.00	0.00	0.00	717.00	0.00	30.00	[illegible]	[illegible]	[illegible]	.00

Cart Center Coda Listing
Effective January 1, 1985 - Updated thru 10-85

OFFICE OF THE PRESIDENTS

10000 Blue Shield Executive
10002 Blue Shield Corporate Executive Special
10003 Executive Assistant - Office of the Presidents
20000 Blue Crorr Executive
20001 Blue Cross Corporate General and Administrative
20002 Blue Cross Corporate Executive Special
20003 Blue Cross-Blue Shield Corporate Special
20004 General Manager & CEO - Health Maintenance of Indiana, Inc.
20005 General Manager - Regional Marketing, Inc.
20006 General Manager. - Associates Lif a Insurance Inc.
20007 Blue Cross-Blue Shield Consulting Special

21000 Internal Auditing

22000 Law Department

23000 Sr. Vice President - Corporate Affairs
23100 Public Relations
23150 Advertising

24500 Human Resources
24600 Compensation and Benef its
24610 Employee Services
24625 Employee Benefits
24630 Health Promotion Services
24640 Personnel Department
24641 Manpower Staffing Temporaries
24642 Interim Staff Control
24800 Organizational Effectiveness 6 Training

30100 Strategic Planning - Administration
30110 Planning and Information Office
30120 Market Research

APPENDIX c

Government Division

8115 Knue Road
Indianapolis, IN 46250

August 2, 1991

Ms. Catherine L. Nocera, CPA
Cotton & Canpany
Certified Public Accountants
100 South Royal Street
Alexandria, Virginia 22314

RE: 1985 and 1986 Medicare FACP Audits

Dear Ms. Nocera:

I received your letter dated July 8, 1991 which requests additional information you need to complete your review of our responses. The following represents our cannents on each of the questions raised. Attachments have also been included where appropriate.

1. Advertising and Promotional Costs

As the attached sheet indicates, only two cost centers which allocate to Medicare in FY 1985 had expenses in account 70104. The total allocation to Medicare A and B was $31 each. Per Mr. Sheffield's workpapers, Associated Insurance Companies, Inc. (AICI) made adjustments for the FACP filing which reduced the charge from account 70104 by $38, thus producing the $7 credits.

Regarding FY 1986, I have attached a summary of all expenses in account 70104 and highlighted the expenses that came from cost centers which do allocate a percentage of their cost to Medicare. As you can see, most of the expenses were in cost center 32300. Cost center 32530 replaced cost center 32300 effective January 1, 1986.

Expenses allocated to Medicare through account 70104 are broken down as follows:

	A	B
CC 32300	$ 327	$ 761
CC 32530	174	251
Other Staff & Support	80	199
Total	$ 581	$1,211

The Associated Group

Attached are most of the invoices supporting the expenses charged to cost centers 32300 and 32530. Review of these invoices does indicate that the "advertising" expensed did involve the encouragement of physicians andothermdical providers of service to file claims electronically (EMC or Paperless). Since Medicare (HCFA) encouraged increased electronic billings during this period and even set goals for increased percentages of EMC claims, we believe that the allocation of a share of these invoices to Medicare is appropriate. Based upon the Medicare detail shown in the previous paragraph, we modify our original response to request reversal of your adjustment as follows:

Part A	$ 501
Part B	$1,012

We accept the part of your adjustment that cam from other staff and support cost centers.

2. <u>Other Unallowable Costs (Outside Printing)</u>

Attached are pages from the General Ledger for December, 1985 which support the -al of $9,347.42 from cost center 31340 and the inclusion of that same expense in cost center 39600. Cost center 39600 is entitled Medicaid Administration and made no charge to Medicare during this period.

3. <u>Other Unallowable Costs (Entertainment)</u>

Attached is a General Ledger summary of expenses charged to cost center 23100 in FY 1986. I have highlighted the two accounts in question. During calendar year 1986, 5.65% of this cost center's expenses were allocated to Medicare A and the same percentage to Medicare B. A computation of expenses charged to Medicare throughthe two entertainment accounts is as follows:

	A	B	Total
Total Expenses	$4,581.03		
Part A %	5.65%		
Part B %		5.65%	
Medicare Allocation	$ 259	$ 259	$ 518

As noted in our original response we believe that cost center 23100 is reasonably allocable to Medicare and that your finding to remove the entire allocation should be reversed. Ifyoudonotpass that finding, thenyoushould reduce your entertainment finding by $518 to avoid a duplication.

4. State Insurance Ccmnissioner's Audit

I checked with Michael K. Brown, my contact at the Blue Cross and Blue Shield Association on FACP audit related issues. He had informed me earlier that this issue had been resolved, but at this time, was unable to find specific cases to hack that up. He did find examples where there ware disagreements on the percentage of audit costs being allocated to Medicare, but none on total disallowance. He did reiterate his opinion that a share of this kind of audit cost is allowable to Medicare and referenced FAR Section 31.205-33 as general support.

As stated previously, our opinion is that the costs of this audit is a general cost of doing business and in that light has some allocability to Medicare. It is a financial audit, not just a review of insurance reserves. On the latest audit, questions ware asked regarding general ledger accounts specific to our Medicare Operations. In addition to all other arguments, HCFA basically contracts with insurance companies to perform as Medicare Intermediaries and Carriers. If this audit is a required aspect of being an insurance company, the cost of the audit should be partially allocable to Medicare.

5. Gains and Losses on the Sale of Depreciable Property

Attached is a reconciliation of Account 62102, Loss & Gain on Sale, for calendar year 1986. The reconciliation shows $188,815 of retirements in October to December, 1986 and a $434,707 correcting entry in November, 1986. Also attached is thetotalpageof the retirements listing from the fixed asset system. From our 1985 review and my understanding of cur standard process, I believed that these retirements were primarily for assets sold or disposed of prior to September 30, 1990. At the time of my previous response, I understood that the correctingentryalso related to transactions in FY 1986.

We just found a box of detailed documentation regarding the property system today. Wewillgetthrough it as quickly as possible and hopefully find the support we need, but1 did not want to wait any longer to respond to your questions.

If you have questions or need additional information, please contact me.

Sincerely,

Dennis W. Brinker
Controller
Government Division

DWB/pml

APPENDIX D

Government Division

8115 Knue Road
Indianapolis, IN 46250

August 22, 1991

Catherine Nocera, CPA
Cotton & Company
Certified Public Accountants
100 South Royal Street
Alexandria, Virginia 22314

RE: FY 1985 and FY 1986 FACP Audits

Dear Ms. Nocera:

On the attached pages, I have provided a narrative response to your questions of August 21, 1991 and copied additional documentation necessary to support the amounts and calculations we discussed.

I believe the only informationmissing is support for the October-December, 1984 transactions in the Gain/Loss account. We will send that information as soon as possible.

If you have questions or need additional information, please contact me.

Sincerely,

Dennis Brinker

Dennis Brinker
Controller
Medicare Operations

DWB/pml

Enclosure

The Associated Group

Complementary Coverage

Overhead Allocations to Medicare - The rationale for excluding these allocated costs from the complementary coverage rate calculation relates to the types of costs allocated to Medicare by the identified cost centers. Each of the cost centers is part of our staff and support operation but provides some specific service rather than general support. Our argument is that these specific services and costs have little or no relationship to the crossover claim process, and thus, shouldbebackedoutof thetotalbefore the crossover rate is computed.

The functions performed by these cost centers were explained in our original response. The attached system generated cost allocation report supports the Medicare A and B allocations identified in our response. Since these reports identify the total Medicare allocation, we needed to compute the amount of the cost allocated to Line 1.

The attached total costs pages were used to calculate the percentage of overhead applicable to Line 1 as is noted on the forms. They were a part of our original response though I agree that we did not clearly identify the computation method. For both A and B, I divided total overhead allocated to Line 1 by total overhead allocated to thepmgramminus direct charges to Productivity Investments. The overhead charged to Productivity Investments was directly identified, not allocated, and has nothing to do with the specific cost centers being backed out of the complementary coverage rate calculation. I believe this approach reasonably identified the overhead charged to Line 1.

Attached is support for the adjustments and deletes added to Part A processed claims and the adjustments and reopenings added to Part B processed claims.

Adjustments/Deletes Summary

Part A

	Adjustments	Deletes
10/85	0	15,765
11/85	0	12,818
12/85	0	14,095
1/86	0	15,433
2/86	0	12,856
3/86	0	**5,416***
4/86	491	5,844
5/86	0	3,843
6/86	0	5,417
7/86	200	5,081
8/86	231	4,315
9/86	459	1,475
TOTAL	1,381	102,358

***NOTE:** Miscounted as 699 in original response.

Part B

	Review&Hearing Adjustments	Reopenings	Total
10-12/85	15,086	70,616	
1-3/86	38,003	109,661	
4-6/86	27,788	84,510	
7-9/86	22,167	84,721	
TOTAL	103,044	349,508	452,552

Total Part B Adjustments and Reopenings increased from our original response due to a clerical. **error** in **compiling** April - June, 1986 data.

Gain/Loss on Sale of Fixed Assets

Your audit workpaper indicates a total gain of $28,172 during the period October, 1984 to December, 1984. We are pulling information fran storage to identify all transactions in this amount for those three months, but it will take a few days to obtain the data. With the small amount involved, it appears that we did not have an accrual problem in late1984 similar to that found in1985 and 1986. I still believe that accruing the Gain/Loss account in FY 1985 and FY 1986 is appropriate.

Attached is additional supporting documentation I just received regarding transactions in the Gain/Loss account in October - December, 1986. The information does support my thought that several of theentries relate to the Medicare year ended September 30, 1986. This data does show that the $434,706 entry in November, 1986 is applicable to Medicare Fiscal Year 1986. The adjusted accrued Gain/Loss for FY 1986 should change a little from our original response. We will provide a revised total as soon as possible.

Costs Incurred but Not Claimed/Replacement Costs

1. Pension Costs applicable to the System Implementation

We set up recipient code 050220 on the Cost Allocation System to segregate costs applicabletothe Arkansas Implementation. What we tried to do in our response on this subject was to identify costs charged to this implementation for HCFA reporting purposes thatexceededthe amounts coming through recipient code 050220.

Theseadditional costs chargedtothe implementation were, I believe, reasonably supported in our original response. The schedules show the total Arkansas Implementation cost (on the FACP in FY 1985, left off the FACP in FY 1986) the amount coming through recipient code 050220 and the cost centers for which manual transfer was made.

Our purpose in this analysis was to identify total Pension cost charged to the Arkansas Implementation and recommend that it be excluded fran your Pension adjustment to avoid a double hit.

Regarding your question on the Pension percentage I used, I agree that it is a percentage based on total personal service, notontotalcosts. The attached pages from the FY 1985 FACP support the 7.9% Pension to total Personal Service. I computed a 5.69% Pension to total Cost Ratio that I agree is more appropriate for my 1985 calculation.

For the FY 1986 Pension calculation, the schedule I sent shows that the $24,468 transferred to the Implementation i: all Personal Service. Looking at the FY 1986 percentage again, I believe the Pension percentage is overstated since we did not claim Pension for the whole of FY 1986. The attached pages from the FY 1986 FACP support Pension expense as 5.03% of total Personal Service. Thus our Pens. reductions should be recalculated as follows:

	FY 1985	FY 1986
Expense Transfer to Implementation	$ 91,697	$ 24,468'
Revised Percentages - Pension	5.69%	5.03%
F&vised Pension Reduction	S 5,218	S 1,231

2. Percentages used to allocate adjustments to the Fixed Price lines where we have replacement costs

In our telephone conversation, you indicated that using percentages of overhead would be more reasonable than the percentages of totalcosts I used for both Part A and Part B. In general, I agree with you and before re-checking the data, had assumed a percentage based on overhead only would be quite comparable tousingtotal costs.

A. Part B - As shownontheattached, the Part B percentage using overhead only is 75.95%. The reason this percentage is lower than using total cost relates to the overhead charge to the EMC Productivity Investment. As shown on the attached schedule titled "Medicare B - FY 1986 FACP", EMC is a direct charge from two cost centers in our staff and support area and not an allocation based upon a percentage of direct costs. Without the EMC cost, Lines l-3 represent 82.3% of the total overhead allocation.

B. Part A - As shown on the Part A attachment titled "Medicare A - FY 1986 FACP", Staff and Support Overhead includes both the EDP and the Overhead columns on the total cost page. If we use overhead as the basis for determining replacement cost, then we should use the total of these two columns minus the unfundedand unreported Arkansas Implementation expense. As I calculated on the attached Total Costs page, this results in 51.30% of total overhead being chargedtolines l-2, a larger percentage than using total costs.