DEPARTMENT OF HEALTH & HUMAN SERVICES
OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDIT SERVICES
150 S. INDEPENDENCE MALL WEST
SUITE 316
PHILADELPHIA, PENNSYLVANIA 19106-3499

February 22, 2001

Our Reference: Common Identification Number A-03-01-00005

Ms. Marilyn Koch
Senior Vice President
Veritus Medicare Services
120 5th Avenue
Suite P 5101
Pittsburgh, Pennsylvania 15222

Dear Ms. Koch:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), Office of Audit Services (OAS) final audit report entitled "**AUDIT OF ADMINISTRATIVE COSTS CLAIMED UNDER PART A OF THE HEALTH INSURANCE FOR THE AGED AND DISABLED PROGRAM BY VERITUS, INC. FOR THE PERIOD OCTOBER 1, 1994 THROUGH SEPTEMBER 30, 1997.**" The audit was performed by the Certified Public Accounting firm of Doshi & Associates, P.C. under a contract with the OIG. A copy of this report will be forwarded to the action official noted below for her review and any action deemed necessary.

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

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

To facilitate identification, please refer to Common Identification Number A-03-01-00005 in all correspondence pertaining to this report.

Sincerely yours,

David M. Long

David M. Long
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Nancy 0' Connor, Acting Regional Administrator
Health Care Financing Administration, Region III
Public Ledger Building Suite **216**
150 S. Independence Mall West
Philadelphia, PA 19106-3499

Report on the Audit of Administrative Costs Claimed Under Part A of the Health Insurance For the Aged and Disabled Program

Veritus, Inc.
Pittsburgh, Pennsylvania

For the Period October 1,1994 through September 30,1997

CIN: A-03-01-00005

DOSHI & ASSOCIATES, P.C.

ACCOUNTANTS AND MANAGEMENT CONSULTANTS

KANSAS CITY, MISSOURI

SUMMARY

The Veritus Inc. (Veritus) claimed Medicare Part A administrative costs for the period October 1, 1994 through September 30, 1997, as follows:

Fiscal Year	Total
1997	$ 18,269,955
1996	17,520,722
1995	18,513,882
Total	$ 54,304,559

Of the $54,304,559 in administrative costs claimed, we are recommending a financial adjustment of $344,231 as detailed in Exhibits and the Findings and Recommendation Section of the report.

We found that Veritus had claimed costs on the Medicare program which were unallowable in accordance with Federal Acquisition Regulations and with provisions of the Medicare contract. There were $330,340 of unallowable costs and $13,891 of unsupported costs.

The unallowable costs consisted of the following:

- An erroneous pension expense adjustment resulted in a $116,955 overstatement of FACP costs claimed.
- Complementary Credits for fiscal year 1995 were understated by $105,315.
- Compensation increases for selected executives were overstated by $69,717 because such increases exceeded average increases for comparable positions, as measured by the Department of Labor, Employment Costs Index (ECI).
- Mileage reimbursement of $34,784 exceeded the allowable limits as stated in the Medicare contract.
- Sales promotion costs of $3,569 were allocated to Medicare that are specifically unallowable in accordance with the contract.

There were $13,891 in claimed costs for which supporting documentation was not provided. Therefore, we were unable to determine the allowability of such costs.

Veritus did not claim a total of $907,713 of allowable costs incurred. That amount represents $247,850 and $659,863 in fiscal years 1995 and 1997 respectively. During the period reviewed, Veritus had deducted those amounts from the total Medicare booked costs to avoid exceeding the CAP as stated in HCFA's Notice Of Budget Approval (NOBA).

Veritus officials concurred with $169,199 of the recommended $344,241 in financial adjustments. Those officials did not agree with our findings and recommendations related to Complementary Credits or Executive Compensation.

Our response to Veritus comments is provided after each finding. Also a copy of Veritus entire response to the draft report is provided as an attachment.

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Manager:

Williams J. Anderson

INDEPENDENT ACCOUNTANT'S REPORT

OPINION

Health Care Financing Administration
Department of Health and Human Services

We have examined the "Final Administrative Cost Proposals" (FACPs) of Veritus Inc. (Veritus) for the fiscal years ended September 30, 1997, 1996, and 1995. These financial statements are the responsibility of Veritus management. Our responsibility is to express an opinion on these financial statements based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, "Government Auditing Standards," and the "Audit Guide For The Review of Administrative Costs Incurred By Medicare Intermediaries and Carriers under Title XVIII of the Social Security Act" (Audit Instruction E-1), dated February 25, 1991, and accordingly, included examining, on a test basis, evidence supporting the FACPs and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

We have identified a total of $344,231 in costs recommended for financial adjustment. The final determination as to whether such costs are allowable will be made by the U.S. Department of Health and Human Services.

Excluded from our examination was a review of pension segmentation. This exclusion was directed by the U.S. Department of Health and Human Services, Office of Inspector General (HHS-OIG).

In our opinion, with the exception of the ultimate resolution of the costs recommended for financial adjustment and any adjustment that might be necessary for pension segmentation, the FACPs referred to above present fairly, in all material, respects, the administrative costs applicable to the Part A Health Insurance for the Aged and Disabled Program, claimed by Veritus for the fiscal years ended September 30, 1997, 1996, and 1995 in accordance with the reimbursement principles of Part 31 of the FAR as contained in 48 Code of Federal Regulations (CFR) Chapter (CH) 1, interpreted and modified by the Medicare Agreements.

This report is intended solely for the use of management within Veritus and the U.S. Department of Health and Human Services in regard to their agreement to administer the Medicare program and should not be used for any other purpose.

Doshi & Associates, P.C.

Doshi & Associates, P.C.

Kansas City, Missouri
September 21, 2000

INTRODUCTION

BACKGROUND

Health Insurance for the Aged and Disabled (Medicare), Title XVIII of the Social Security Act, provides for a hospital insurance program (Part A) and a related medical insurance program (Part B) for (1) eligible persons aged 65 and over, (2) disabled persons under age 65 who have been entitled to Social Security or Railroad Retirement disability benefits for at least 24 consecutive months, and (3) individuals under age 65 with chronic kidney disease who are currently insured by or entitled to Social Security benefits.

Medicare Part A, Hospital Insurance Benefits for the Aged and Disabled, provides protection against the costs of hospital inpatient care, post-hospital extended care in nursing facilities, and post-hospital home health care. The Medicare program is administered by the Health Care Financing Administration (HCFA), which is a division of the U.S. Department of Health and Human Services.

The Veritus Inc. (Veritus), d/b/a Veritus Medicare Services, has been designated a Medicare Part A fiscal intermediary (FI). Veritus is responsible for the receipt, review and payment of Medicare claims submitted by hospitals, nursing homes, and home health agencies that they service. Administrative costs incurred in connection with Veritus activities are accumulated in cost centers and subsequently charged directly or allocated indirectly to various lines of business, including Medicare Part A.

SCOPE

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, "Government Auditing Standards," and the "Audit Guide for the Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers under Title XVIII of the Social Security Act" (Audit Instruction E-1), dated February 25, 1991. Accordingly, we examined, on a test basis, evidence supporting the FACPs and performed such other procedures as we considered necessary in the circumstances.

In performing our examination, we:

- reviewed significant internal controls over compliance areas;

- performed detail testing of major cost categories and examined executive compensation, general and administrative expenses, and complementary credits; and

- determined whether recommendations identified during the previous administrative cost examination were implemented.

To avoid duplication of audit effort, we relied on the work performed by:

- the independent certified public accounting firm of Price Waterhouse Coopers LLP in reconciling the corporate accounting records to the financial statements, as well as, their testing or analysis of the payroll system, cash disbursement system, fixed assets, and depreciation accounts; and

- Veritus Internal Audit for their review of internal controls over accounts payable and cost allocations.

Our review of internal controls over compliance covered the financial reporting, timekeeping, and inventory systems, allowability of costs in accordance with Part 31 of the FAR as interpreted and modified by the Medicare agreement, and contractual requirements governing specific items of costs. That review, combined with our reliance on external and internal audit work, was made for the limited purpose of determining the nature, timing and extent of the auditing procedures necessary for expressing an opinion on the FACPs. Because our study of internal control was made for the limited purpose, it would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on Veritus system of internal accounting control taken as a whole or on any of the categories identified above. However, our study disclosed instances of noncompliance (see the Findings and Recommendations Section of this report).

Our testing covered the major cost categories such as, salaries, fringe benefits, facility and occupancy and EDP costs. In addition, we reviewed general administrative costs, return on investment and complementary credits. Our sample selections for detail testing were made with the primary emphasis upon significant, unusual and/or possibly unallowable transactions.

The examination excluded a review of pension segmentation. A separate audit of the Veritus pension plan for compliance with segmentation requirements will be performed at a later date.

The fieldwork was performed at Veritus Inc., Pittsburgh, Pennsylvania during July through September 2000.

FINDINGS AND RECOMMENDATIONS

PENSION EXPENSE

Veritus inadvertently made an error in adjusting its fiscal year 1996 original FACP total costs claimed. As a result, the costs claimed on the FACP Supplemental No. 1 were overstated by $116,955.

The original Fiscal Year 1996 FACP included a total of $295,879 of pension costs claimed. That amount consisted of $243,280 in pension costs for Veritus and $52,599 for the two subcontractors, Blue Cross of Northeastern Pennsylvania and Capital Blue Cross.

In December 1996, Veritus Inc. (d/b/a) Blue Cross of Western Pennsylvania (BCWP) combined with Medical Service Association of Pennsylvania (d/b/a) Pennsylvania Blue Shield (PBS) to form Highmark Inc. Because of the reorganization, Highmark Inc. contracted William Mercer Associates to perform an actuarial study of the existing pension plans. The intent of the study was to provide for consistency in the calculation of pension costs for Highmark affiliates.

The actuary restated pension costs in accordance with CAS principles and recommended a $175,176 downward reduction in the Veritus pension expenses. Accordingly, Veritus claimed $68,104 in pension expenses on Medicare with $52,599 for the two subcontractors. In total Veritus reported the appropriate amount of $120,703 in pension costs on the FACP Supplement No. 1.

However, Veritus failed to properly adjust the actual detail costs claimed. As a result, the total costs claimed on the final 1996 FACP Supplemental No. 1 are overstated by $116,955. That adjustment included not only pension but other cost categories.

In our initial discussions on pension expense, Veritus officials acknowledged that the adjustment was in error and indicated the FACP would be revised to further reduce cost claimed by $116,955. It was agreed that we would report the error and recommend an adjustment rather than Veritus submit a revised FACP.

Recommendation:

We recommend that Veritus make a financial adjustment of $116,955 to the Fiscal Year 1996 FACP costs claimed to correct overstated pension expenses.

Veritus Comment

Veritus officials agree with this finding and recommendation.

COMPLEMENTARY CREDITS

Complementary credits applicable to Medicare were understated in fiscal year 1995 by $105,315. That amount represented the variance between the $.40 per claim as credited by Veritus and the $.56 per claim as recommended by HCFA in the fiscal year 1994 Risk Assessment Analysis.

The HCFA issued a directive in January 1995 that required all Part A Intermediaries to apply a standardized complementary rate of $.69 per claim for fiscal year 1995. That directive allowed the intermediary to continue to apply a lower rate in fiscal year 1995 if an agreement was still in effect with another insurer. Veritus applied the standardized rate after March 16, 1995. From October 1, 1994 through March 16, 1995, Veritus was applying $.40 per claim.

A Risk Assessment Analysis was performed by HCFA that covered fiscal year 1994. As a result of that review, HCFA determined the complementary credit rate should be $.56 per claim rather than the $.40 as applied by Veritus. We applied HCFA's recommended rate of $.56 to all complementary claims processed from October 1, 1994 through March 16, 1995 and compared that amount to credits processed by Veritus. That comparison showed the following:

	Credit Per Claim		
Total Complementary Claims Processed	Veritus $.40	Audit $.56	Amount Understated
662,981	$265,954 (a)	$371,269	$105,315

(a) This is the actual amount credited by Veritus.

Recommendation:

We recommend that Veritus make a financial adjustment to reduce the fiscal year 1995 FACP costs claimed by $105,315 to correct understated complementary credits.

Veritus Comment

Veritus officials do not agree with our recommendation. Those officials indicate that Veritus is currently in the process of negotiating an outstanding audit finding on the Complementary Credit rate used in fiscal years 1986 through 1993. Veritus is referring to two prior audits performed by OIG that covered Medicare administrative costs for fiscal years 1986-1989 and 1990-1993.

In those reports OIG reported that Veritus had failed to include all relevant costs benefiting the Complementary Insurance Program in its calculation of the credit. Veritus disagreed with the finding and indicated that OIG's understanding of its complementary claim processing system was in error. That misunderstanding according to Veritus resulted in OIG calculating an overstated rate.

Regarding the current audit, Veritus officials indicated the adequacy of our recommended $.56 rate should be assessed based on the outcome of the resolution of the prior audits.

Auditor's Response

We did not attempt to evaluate the reasonableness of the $.40 rate applied by Veritus. Instead, we utilized the $.56 rate recommended as reasonable by HCFA in its fiscal year 1994 Risk Assessment Analysis. We considered HCFA's Risk Assessment Analysis for fiscal year ended September 30, 1994 to be the final settlement of costs claimed for that year. As such, the $.56 rate would appear to be reasonable for claims processed from October 1, 1994 through March 1, 1995.

EXECUTIVE COMPENSATION

During our review period, Medicare was allocated $69,717 in executive compensation increases which exceeded the average increases for comparable positions, as measured by the U.S. Department of Labor, Bureau of Labor Statistics, Employment Cost Index (ECI). These charges are considered unreasonable and thus unallowable.

Regulations to which the contractors must adhere support the position that compensation charged to Medicare must be reasonable. Section 31.205-6 (b)(1) of the FAR, which has been incorporated by specific reference in the Medicare contract, state, in part:

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

The onus, therefore, is placed on the contractor to show that compensation is reasonable. In reviewing the reasonableness of increases to executive compensation, we used the nationwide averages for executive and managerial employees employed in the private sector, as measured by the U.S. Department of Labor's (DOL) Bureau of Labor Statistics Employment Cost Index (ECI).

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

For executives in managerial/administrative occupations, the ECI had the following average compensation increases:

CY	1995	2.9%
CY	1996	3.5%
CY	1997	4.6%

We compared the actual increases received by those executives, vice presidents and above, that allocated any compensation to Medicare. Because of retirements and corporate reorganization not all executives were in the comparison for the full 3-year period. Therefore, compensation increases were calculated as follows:

- base year was either the executives actual compensation packages for CY 1994, or their compensation package for a later year if not employed in CY 1994;

- final year of our review was either the compensation package for CY 1994 or the package for the year in which the executive retired, terminated or transferred, if prior to CY 1997; and

- excess compensation charged to Medicare was calculated based on the same cost methodology as Veritus applied in developing the FACPs.

We did not attempt to determine the reasonableness of the base year compensation packages. Further, the compensation packages generally included only salary and incentive.

We determined that 33 executives had a portion of their compensation allocated to Medicare during the 3-year period reviewed. However, of those executives, only 8 allocated 2 percent or more of their compensation to Medicare in any of the 3 years. The remaining executives allocated amounts less than 2 percent ranging from .07 to 1.96 percent.

Of the 33 executives, we included 8 executives who had increases of any significance and allocated more than 2 percent to Medicare. During the period of review those 8 executives received compensation amounts that exceeded the ECI by a total of $1,031,378. Medicare was allocated $69,717 of that amount during the 3 fiscal years ended September 30, 1997.

Recommendation:

We recommend that Veritus make a financial adjustment to the FACP costs claimed by the following amounts for excessive executive compensation:

Fiscal Year	Amount
1997	$41,539
1996	18,142
1995	10,036
Total	$69,717

Veritus Comment

Veritus officials disagree with the finding and recommendation. Specifically those officials indicate that:

- The ECI is a broad based index that will not necessarily result in appropriate levels of compensation on an individual basis. In contrast, Veritus employee increases are driven by each individual's past performance and compensation surveys tailored for the specific markets in which Veritus competes for various classes of employees;
- There is no contractual or statutory law in effect that requires use of the ECI; and
- HCFA in response to OIG's August 1994 "Review of Executive Compensation At Medicare Contractors" report (A-03-94-00004) noted that there was no basis for applying the ECI to contractors.

In summary Veritus officials do not believe that the ECI formula can be legitimately applied to the period under review.

Auditor's Response

The ECI is a widely recognized, unbiased measure of compensation practices. As a result the OIG provided audit steps requiring use of the ECI. Further, the final determinations on this issue are made by HCFA.

SUPPLEMENTAL MILEAGE EXPENSE

During the period of our review, Veritus charged $34,784 to Medicare in unallowable auto mileage expenses. That amount represented a $.11 per mile supplemental mileage allowance that exceeded the allowable rate established in the Medicare contract.

Appendix B, Paragraph XII of the Medicare contract limits reimbursement for automobile travel costs to "actual costs not to exceed the rate published in the Federal Travel Regulations." The published mileage rates for the years audited were as follows:

1995	1996	1997
$.30 per mile	$.31 per mile	$.315 per mile

Our review showed that Veritus was reimbursing employees the published rate for mileage up to 1,000 miles a year. For mileage over 1,000 miles a year, the employee was reimbursed an additional $.11 per mile. The additional $.11 per mile exceeds the allowable reimbursement as stated in Appendix B.

A total of $34,784 was claimed on Medicare during the period reviewed for the supplemental mileage expense. According to Veritus officials the supplemental mileage payments were discontinued in fiscal year 1998.

Recommendation:

We recommend that Veritus make a financial adjustment to the FACP for excessive supplemental mileage expense claimed as follows:

Fiscal Year	Amount
1997	$11,954
1996	11,901
1995	10,929
Total	$34,784

Veritus Comment

Veritus officials agree with our recommendation and indicate that supplemental mileage reimbursements were discontinued in fiscal year 1998.

SALES PROMOTION EXPENSE

During the period of our review Medicare was allocated $3,569 in sales promotion expenses. These type costs do not benefit Medicare and are questioned as unallowable.

In accordance with Paragraph XV-A.1. of the Medicare Contract, Specific Unallowable Items:

> *"A. All direct and indirect costs which relate to the contractor's non-Medicare business and do not contribute to the Medicare agreement/contract. These include, but are not limited to:*
>
> *1. costs related to the acquiring or enrolling of new subscribers, including selling, advertising, and other promotional costs,..."*

Our review showed that the specific costs included in the sales promotion expenses were related to non-Medicare business. For example, Veritus paid $10,500 as a sponsorship fee for Inroads Incorporated, St. Louis, Missouri. Also, Veritus paid $2,450 to sponsor a booth for the NAACP at a job fair. Medicare was allocated a portion of those costs.

In our opinion these type expenses provide no benefit to Medicare and are unallowable.

Recommendation:

We recommend that Veritus make a financial adjustment to the FACP for sales promotion costs claimed as follows:

Fiscal Year	Amount
1997	$1,156
1996	2,215
1995	198
Total	$3,569

Veritus Comment

Veritus officials agree with our recommendation.

UNSUPPORTED COSTS

Veritus allocated $13,891 to Medicare in costs for which the documentation supporting the expenditure was not adequate to determine the nature, type, reasonableness or necessity of the expense. During our transactional analysis, we identified transactions totaling $236,771 for which Veritus either did not provide supporting documentation or the documentation provided proved inadequate. Article XX of the Medicare Part A Plan Subcontract states that:

> *"The Plan shall maintain adequate accounting records covering the use of funds under this agreement...These records shall be maintained for the time periods for particular records specified in Subpart 4.7 of the FAR...The Secretary shall have access to and the right to examine any directly pertinent books, documents,*

papers, and records of the Plan, and those of any parent, affiliated, or subsidiary."

Consequently, we were unable to verify the accuracy of the transactions or determine the relationship of $13,891 in expenses charged to the Medicare program.

Recommendation:

We recommend that Veritus make a financial adjustment to the FACP for unsupported costs claimed by the following amounts:

Fiscal Year	Amount
1997	$12,171
1995	1,720
Total	$13,891

Veritus Comment

Veritus officials agree with our recommendation.

OTHER MATTERS

INTERIM EXPENDITURE REPORTS

Based on a comparison of the IER's as submitted by Veritus to HCFA and amounts claimed on the FACP, we concluded the IER's were materially accurate.

PART A BENEFIT PAYMENTS

Veritus made Part A benefit payments in the following amounts:

Fiscal Year	Number of Claims (Million)	Benefits Paid (Billion)
1997	6.5	$4.6
1996	6.0	4.2
1995	6.0	3.7
Total	18.5	$12.5

FOLLOW UP ON PRIOR FINDINGS

The HHS/OIG Office of Audit Services performed an audit of the Part A administrative costs claimed by Veritus covering the period fiscal years 1990 through 1993. The OIG report, dated February 25, 1998, contained recommendations totaling $3,140,363 in questioned costs and a procedural recommendation related to strengthening the Veritus cost allocation system.

Based on discussions with both HCFA and Veritus officials, we were told that the recommended financial adjustments have not been resolved. Further, no reimbursements have been made by Veritus for the questioned costs.

For the period covered in our review, we determined that Veritus had strengthened its internal controls over cost allocation and taken other actions to eliminate potentially unallowable costs. The corrective actions taken include:

1. Cost Allocation System
   Veritus has completed internal control surveys and performed risk assessments of Medicare activities as part of its yearly management control certification process. These surveys covered such activities as accounts payable, employees expense reimbursement, fixed asset purchases and capitalization, cost allocation, and unallowable costs. A number of internal controls have been implemented as a result of those surveys. Our current review disclosed no significant adjustments resulting from weaknesses in those systems.

2. Complementary Credits
   HCFA standardized the Part A Complementary Credit at $.69 per claim in fiscal year 1995. That action eliminated the questions concerning the accuracy and reasonableness of complementary credit rates.

3. Accrued Rent Expense
   Veritus negotiated a revised lease on the Fifth Avenue Place in August 1993. The new lease eliminated the increase factor as questioned in the prior audit.

4. Productivity Investment Costs
   Veritus established the necessary controls to identify incremental costs on productivity investment projects. For example, on the Florida Shared System (FSS) project there were a total of $1,738,728 costs recorded. However, only $728,500 was claimed. The variance represented permanent staff costs of $1,010,228. The latter amount was eliminated and not claimed. No overhead or general and administrative costs were allocated to the project.

Except for the Executive Compensation finding, it appears that Veritus has implemented the necessary internal controls to eliminate the type of findings previously reported.

Doshi & Associates, P.C.

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Manager:

Williams J. Anderson

INDEPENDENT ACCOUNTANT'S REPORT ON COMPLIANCE

Health Care Financing Administration
Department of Health and Human Services

We have examined management's assertion included in the Final Administrative Cost Proposal that except for noncompliance described in the third paragraph, Veritus Inc. (Veritus) complied with the reimbursement principles of Part 31 of the FAR as contained in 48 Code of Federal Regulations (CFR) Chapter (CH) 1, interpreted and modified by the Medicare Agreements for the three fiscal years ended September 30, 1997. Management is responsible for Veritus compliance with those requirements. Our responsibility is to express an opinion on Veritus compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and the "Audit Guide for the Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers Under Title XVIII of the Social Security Act" (Audit Instruction E-1), and accordingly, included examining, on a test basis, evidence about Veritus compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on Vertitus compliance with specified requirements.

Our examination disclosed material noncompliance as identified in the Findings and Recommendation section of this report with the reimbursement principles applicable to Veritus for the three fiscal years ended September 30, 1997.

Excluded from our examination was a review of pension segmentation. This exclusion was directed by the U.S. Department of Health and Human Services, Office of Inspector General (HHS-OIG).

In our opinion, except for the material noncompliance described in the third paragraph and adjustments that might be necessary for pension segmentation, Veritus complied, in all material aspects, with the reimbursement principles of Part 31 of the FAR as contained in 48 Code of Federal Regulations (CFR) Chapter (CH) 1, interpreted and modified by the Medicare Agreements for the four fiscal years ended September 30, 1998.

This report is intended solely for the use of management of Veritus and the U.S. Department of Health and Human Services in regard to their agreement to administer the Medicare program and should not be used for any other purpose.

Doshi & Associates. P.C.

Kansas City, Missouri
September 21, 2000

Doshi & Associates, P.C.

Exhibit A

VERITUS INC.
FINAL ADMINISTRATIVE COST PROPOSAL
AND AUDITOR'S RECOMMENDATIONS
FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 1997

Operation		Administrative Costs
Bills Payment	$	8,641,847
Recons and Hearings		501,162
Medicare Secondary Payer		1,476,961
Medical Rev & Util. Rev		1,492,698
Provider Desk Reviews		1,643,966
Provider Field Audits		1,379,903
Provider Settlements		583,986
Provider Reimbursement		1,637,936
Productivity Investments		1,110,759
Benefits Integrity		807,353
MIP Other		-
Other		25,539
Credits/ Other		(1,032,155)
Total FACP Costs Claimed	$	18,269,955
Recommended Adjustments		
Executive Compensation	$	(41,539)
Excess Mileage		(11,954)
Unsupported Costs		(12,171)
Sales Promotion		(1,156)
Total Adjustments		(66,820)
Total Recommended For Acceptance	$	18,203,135

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

Exhibit B

VERITUS INC.

FINAL ADMINISTRATIVE COST PROPOSAL
AND AUDITOR'S RECOMMENDATIONS
FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 1996

Operation		Administrative Costs
Bills Payment	$	9,026,034
Recons and Hearings		441,608
Medicare Secondary Payer		1,803,281
Medial Rev & Util. Rev		1,369,619
Provider Desk Reviews		1,620,521
Provider Field Audits		1,435,870
Provider Settlements		693,445
Provider Reimbursement		1,196,402
Productivity Investments		220,951
Benefits Integrity		427,727
Other		247,167
Credits		(961,903)
Total FACP Costs Claimed	$	17,520,722
Recommended Adjustments		
Pension Expenses	$	(116,955)
Executive Compensation		(18,142)
Excess Mileage		(11,901)
Sales Promotion		(2,215)
Total Adjustments		(149,213)
Total Recommended For Acceptance	$	17,371,509

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

Exhibit C

VERITUS INC.

FINAL ADMINISTRATIVE COST PROPOSAL
AND AUDITOR'S RECOMMENDATIONS
FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 1995

Operation		Administrative Costs
Bills Payment	$	9,343,920
Recons And Hearings		449,568
Medicare Secondary Payer		2,148,580
Medical Rev & Util. Rev		1,061,520
Provider Desk Reviews		1,400,694
Provider Field Audits		1,590,572
Provider Settlements		737,756
Provider Reimbursement		1,330,685
Productivity Investments		831,629
Benefits Integrity		378,104
Other		186,050
Credit		(945,196)
Total FACP Costs Claimed	$	18,513,882
Recommended Adjustments		
Complimentary Credits	$	(105,315)
Executive Compensation		(10,036)
Excess Mileage		(10,929)
Unsupported Costs		(1,720)
Sales Promotion		(198)
Total Recommended Adjustments		(128,198)
Total Recommended For Acceptance	$	18,385,684

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

HIGHMARK℠

Marilyn Koch
Senior Vice President

January 19, 2001

Mr. Kant D. Doshi
Doshi & Associates, P.C.
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4520 Madison, Suite 105
Kansas City, MO 64111

Re: Medicare Administrative Cost Audit Draft Report

Dear Mr. Doshi:

Attached is a response to your letter of December 14, 2000 requesting comments on your Draft Report CIN: A-03-01-00005, titled "Report on the Audit of Administrative Costs Claimed Under Part A of the Health Insurance For the Aged and Disabled Program" for Fiscal Years 1995, 1996 and 1997.

If you have any questions, please feel free to contact me at 412.544.1800 or Lou Lamanna at 412.544.1931.

Sincerely,

Marilyn Koch

MK/pm/doshi01192001

cc: Robert Taylor
Charlotte Foster
James White
Patricia Volk
Elizabeth Farbacher
Gayeta Porter
Lou Lamanna

REVIEW OF MEDICARE PART A ADMINISTRATIVE COSTS FOR FISCAL YEARS 1995 – 1997

VERITUS MEDICARE SERVICES

COMMENTS TO DRAFT REPORT
CIN: A-03-01-00005

INTRODUCTION

Doshi & Associates, P.C. performed an audit of Veritus Medicare Services (VMS) Medicare Part A administrative costs for the period October 1, 1994 through September 30, 1997. Except for expenses totaling $344,231 and any adjustment that might be necessary for pension segmentation, the auditors concluded that the Final Administrative Cost Reports (FACPs) present fairly, in all material respects, the administrative costs applicable to the Medicare Part A program at VMS. The auditors recommended financial adjustments of $344,231, that consisted of the following individual items:

A. $116,955 overstatement of the FACP costs claimed as a result of an erroneous pension expense adjustment

B. $105,315 understatement of complementary credits for fiscal year 1995

C. $69,717 overstatement of selected executives compensation due to increases exceeding average increases for comparable positions, as measured by the Department of Labor, Employment Costs Index (ECI)

D. $34,784 overstatement of costs as a result of the mileage reimbursement exceeding the allowable limits as stated in the Medicare contract

E. $3,569 overstatement of cost as a result of sales promotion costs that were allocated to Medicare but are specifically unallowable in accordance with the contract

F. $13,891 of claimed costs for which supporting documentation was not provided

VMS has reviewed the Draft Report; the following are comments relevant to each of the auditor's recommendations:

A. PENSION EXPENSE -- $116,955

VMS does not contest this finding. VMS inadvertently made an error in adjusting the fiscal year 1996 FACP that resulted in an overstatement of claimed pension costs. We identified this inappropriate adjustment in preparing for the audit and brought this issue to the auditor's attention.

B. COMPLEMENTARY CREDIT--$105,315

The auditors based this adjustment recommendation on a complementary credit rate determined by HCFA during a fiscal year 1994 Risk Assessment Analysis.

VMS is currently in the process of negotiating a resolution to an outstanding audit finding on the complementary credit rate used in fiscal years 1986 through 1993. Pending resolution of these previous years, VMS disagrees with this finding for the reasons previously stated in the "Review of Medicare Administrative Costs Fiscal Years 1986 – 1989" report and the "Review of Medicare Part A Administrative Costs Fiscal Years 1990 – 1993" report. We believe the outcome of that negotiation should be used as the basis to assess the adequacy of the rate used during the period October 1, 1994 through March 16, 1995.

C. EXECUTIVE COMPENSATION--$69,717

VMS disagrees with this finding. We believe the application of a broad index such as the ECI will not necessarily result in appropriate levels of compensation on an individual basis. Increases in compensation rates for all employees are driven by each individual's past performance and compensation surveys tailored for the specific markets and industries with which we compete for various classes of employees. The company's compensation practices include consideration of base compensation in determining the annual increases. Therefore, the application of the ECI to the base compensation is inconsistent with this business practice.

In addition, there is no requirement to utilize ECI. We found no contractual or statutory law in effect during the time period for which this review was conducted (fiscal years 1995 – 1997). The earliest statutory requirement we located was 48 CFR 31.205-6(p). This addresses costs incurred after January 1, 1998 which is subsequent to the review period.

Also, HCFA in responding to the OIG's August 1994 "Review of Executive Compensation At Medicare Contractors" report (A-03-94-00004) noted that there was no basis for applying this formula to contractors. Their July 20, 1994 response states:

HCFA Response

"We agree that Medicare should not be allocated unreasonable or excessive increases in executive compensation. Extensive contract negotiations, however, will need to take place before HCFA can unilaterally place a ceiling on executive salary increases, especially since the Medicare contracts are cost reimbursed agreements. We will inform contractors of our intention to limit salaries within the context of our current agreements. Also, limits on executive salary increases will be included as part of any renegotiated contracts that will be needed to implement the Medicare Transaction System.

We also agree that the ECI could be used as a comparative measure to determine unreasonable and excessive officers' compensation. However, there are methods other than the ECI that can be used to limit compensation at Medicare carriers and intermediaries. ..."

To date, HCFA has yet to renegotiate the contracts, the current contract has been in place since 1987. Therefore, we do not believe that the ECI formula can be legitimately applied to the time period under review.

D. SUPPLEMENTAL MILEAGE EXPENSE -- $34,784

VMS does not contest this finding. In certain circumstances, a supplemental mileage allowance was provided to employees above the published mileage rates. This supplemental cost was inadvertently included in the FACPs. The supplemental mileage reimbursements were discontinued in fiscal year 1998.

E. SALES PROMOTION EXPENSE -- $3,569

VMS does not contest this finding. VMS inadvertently included these expenses in the FACP and agrees these expenses did not relate to Medicare business.

F. UNSUPPORTED COSTS -- $13,891

The documentation requested by the auditors to support these costs was being used in context with another audit and can not be timely located. We are continuing the search for this documentation but, in the interest of closing this matter, will not contest this finding.

ADDITIONAL COMMENTS – ALLOWABLE COSTS NOT CLAIMED

VMS provided documentation for $247,850 of allowable costs incurred in fiscal year 1995 but not claimed to avoid exceeding the CAP as stated in HCFA's Notice of Budget Approval (NOBA). Similarly, VMS provided documentation for expense allocated to Medicare Part A during fiscal year 1997 in relation to the company's voluntary early retirement program ($898,363) versus the amount actually claimed on the FACP ($238,500). Therefore, in fiscal year 1997, there exists $659,863 of allowable costs not claimed. We believe these unclaimed costs should be taken into consideration in the final settlement of costs for the related fiscal years.