Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

NATIONAL HERITAGE INSURANCE COMPANY
CHICO, CALIFORNIA

AUDIT OF MEDICARE FINAL ADMINISTRATIVE COST PROPOSALS FOR THE PERIOD OCTOBER 1, 1998 THROUGH SEPTEMBER 30, 2000

JANET REHNQUIST
Inspector General

JANUARY 2002
CIN: A-09-01-00088
Office of Inspector General
http://www.oig.hhs.gov

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Trace Woodward  
Chief Financial Officer  
National Heritage Insurance Company  
402 Otterson Drive  
Chico, CA 95928  

Dear Mr. Woodward:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General, Office of Audit Services' (OAS) report entitled “National Heritage Company Audit of Medicare Final Administrative Cost Proposals for the Period October 1, 1998 through September 30, 2000.” Should you have any questions or comments concerning the matters commented on in this report, please direct them to the HHS official named below.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), 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 exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.) As such, within 10 business days after the final report is issued, it will be posted to the World Wide Web at http://oig.hhs.gov/.

To facilitate identification, please refer to Common Identification Number A-09-01-00088 in all correspondence relating to this report.

Sincerely,

Lori A. Ahlstrand  
Regional Inspector General  
for Audit Services  

Enclosures – as stated  

Direct Reply to HHS Action Official:
The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represents the findings and opinions of the HHS/OIG Office of Audit Services. Final determination of these matters will be made by authorized officials.
Dear Mr. Woodward:

The purpose of this report is to provide National Heritage Insurance Company (NHIC) with the results of our audit of administrative costs. The primary purpose of the audit was to express an opinion as to whether NHIC’s final administrative cost proposals (FACP) for the period October 1, 1998 through September 30, 2000 presented fairly the allowable costs of administration of the Medicare program in conformity with the reimbursement principles contained in the Federal Acquisition Regulations (FAR).

We have concluded that $118,199,816 of the $128,100,962 claimed under the contract is acceptable. The balance of $9,901,146 represents costs set aside for pension costs ($801,140), home office indirect costs ($8,568,685), return on investment ($73,729), and the amount budgeted for forward funding ($457,592).

In written response to our report, NHIC concurred with our findings. The NHIC’s comments are included in their entirety as an APPENDIX to this report.

INTRODUCTION

BACKGROUND

The Medicare program is a Federal health insurance program whose beneficiaries include persons 65 years of age or over, disabled or blind persons, or those suffering from chronic renal disorders. Medicare was established by Congress in 1965 through the enactment of Title XVIII of the Social Security Act. Medicare consists of two distinct parts. Hospital Insurance (Part A) covers expenses of medical services furnished in an institutional setting, such as a hospital or a skilled nursing facility, or provided by a home health agency. Supplemental Medical Insurance (Part B) covers physician services, certain other medical equipment and services, and other outpatient services.

The Medicare program is administered by the Centers for Medicare & Medicaid Services (CMS), which contracted with NHIC to receive, review, audit and pay Medicare Part B
claims. The NHIC is entitled to reimbursement for the allowable administrative costs incurred, up to the contract ceiling, in carrying out its responsibilities under the program.

The administrative costs reported by NHIC for processing claims totaled $128,100,962 for the period October 1, 1998 through September 30, 2000.

SCOPE OF AUDIT

Our audit was performed in accordance with generally accepted government auditing standards. The primary purpose of the audit was to express an opinion as to whether NHIC’s final administrative cost proposals for the period October 1, 1998 through September 30, 2000 presented fairly the allowable costs of administration of the Medicare program in conformity with the reimbursement principles contained in the FAR.

Pension and home office indirect cost allocations for general and administrative (G&A) costs as well as return of investment costs (ROI) claimed by NHIC and included in the FACP’s were excluded from the scope of our audit. The Office of the Inspector General will perform a separate audit to determine the allowability of the pension costs claimed in accordance with the FAR, Title 48, Chapter 1, Part 21.205-6(j) and Cost Accounting Standards 412 and 413. Indirect cost rates used by NHIC are subject to audit by the Defense Contract Audit Agency (DCAA) and any changes to the rates used and those finally approved by DCAA could result in further adjustments to the FACP costs as claimed.

In planning and performing our audit, we considered the internal control structure in order to determine our auditing procedures. This evaluation was for the purpose of expressing an opinion on the FACP’s and not to provide assurance on the internal control structure.

The management of NHIC is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of an internal control structure. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition. Inherent limitations in any control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

The period covered by our audit was October 1, 1998 through September 30, 2000. The audit field work was conducted at NHIC’s Chico, California office in September 2001.
RESULTS OF AUDIT

We have concluded that $118,199,816 of the $128,100,962 claimed under the contract is acceptable. The balance of $9,901,146 represents costs set aside for pension costs ($801,140), home office indirect costs ($8,568,685), return on investment ($73,729), and the amount budgeted for forward funding ($457,592).

Pension costs are set aside pending a separate audit by the Office of Inspector General, Office of Audit Services, Region VII. Home office indirect costs and return on investment are set aside pending an audit by DCAA.

The $457,592 for forward funding represents the amount budgeted by CMS for NHIC’s transition to be the Medicare contractor in Southern California in FY 2001. We do not express an opinion on the amount budgeted.

NHIC concurred with our findings. NHIC’s response is included in its entirety as Appendix A.

Sincerely,

[Signature]
Lori A. Ahlstrand
Regional Inspector General
for Audit Services
## NATIONAL HERITAGE INSURANCE COMPANY

CHICO, CALIFORNIA

SUMMARY OF RESULTS OF AUDIT
OF MEDICARE ADMINISTRATIVE COSTS
FOR THE PERIOD
OCTOBER 1, 1998 THROUGH SEPTEMBER 30, 1999

<table>
<thead>
<tr>
<th>Category of Cost</th>
<th>Total</th>
<th>Costs</th>
<th>Notes</th>
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<tbody>
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<td>Proposed</td>
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<td>Total</td>
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<td>$4,860,213</td>
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NOTES TO SCHEDULE 1

Note 1. The costs represent home office indirect costs, which we set aside pending a review by DCAA.

Note 2. The $904,068 represents home office indirect costs of $505,082, which we set aside pending a DCAA review, and pension costs of $398,986, which will be audited separately by our Region VII office.

Note 3. The $29,341 represents return on investment costs, which we set aside pending a review by DCAA.
### NATIONAL HERITAGE INSURANCE COMPANY
CHICO, CALIFORNIA
SUMMARY OF RESULTS OF AUDIT
OF MEDICARE ADMINISTRATIVE COSTS
FOR THE PERIOD
OCTOBER 1, 1999 THROUGH SEPTEMBER 30, 2000

<table>
<thead>
<tr>
<th>Category of Cost</th>
<th>Total</th>
<th>Costs</th>
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</thead>
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<td>Telephone and telegraph</td>
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<td>Postage and express mail</td>
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<td>Forward funding</td>
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**Total** | **$68,132,971** | **$5,040,933**
NOTES TO SCHEDULE 2

**Note 1.** The costs represent home office indirect costs, which we have set aside pending a review by DCAA.

**Note 2.** The $949,088 represents home office indirect costs of $546,934, which we set aside pending a DCAA review, and pension costs of $402,154, which will be audited separately by our Region VII office.

**Note 3.** The $44,298 represents return on investment costs, which we set aside pending a review by DCAA.

**Note 4.** The $457,592 for forward funding represents the amount budgeted by CMS for NHIC’s transition to be the Medicare contractor in Southern California in FY 2001. We do not express an opinion on the amount budgeted.
APPENDIX A

AUDITEE’S RESPONSE
December 19, 2001

Common Identification Number
A-09-01-00088

December 19, 2001

Centers for Medicare & Medicaid Services
Lori A. Ahlstrand, Regional Inspector General
Region IX
Office of Audit Services
50 United Nations Plaza
San Francisco, CA 94102

Dear Ms. Ahlstrand:

We have received and reviewed the U.S. Department of Health and Human Services, Office of the Inspector General, Office of Audit Services, National Heritage Insurance Company draft report, entitled “Audit of Medicare Final Administrative Cost Proposals for the Period October 1, 1998 through September 30, 2000.”

We concur with the results, schedules and notes to Schedules 1 and 2.

Should you have any further questions or concerns, I can be reached at (530) 896-7108.

Sincerely,

Trace Woodward
Chief Financial Officer
Medicare Administrative Services

cc: Sharon Burgess, CMS
    Diane Teakle, CMS
    Kirk Sadur, CMS
    Jeff Broocks, NHIC
    Anne Bockhoff Dalton, NHIC