

**Memorandum**

Date MAR 21 1995

From June Gibbs Brown
Inspector General *June G Brown*

Subject Review of Home Office General and Administrative Costs Claimed by ABC Home Health Services, Inc. (A-04-93-02067)

To Bruce C. Vladeck
Administrator
Health Care Financing Administration

Attached are two copies of our final report entitled, "Review of Home Office General and Administrative Costs Claimed by ABC Home Health Services, Inc." The objective of our review was to determine the allowability of general and administrative (G&A) costs claimed by ABC Home Health Services, Inc. (ABC) in its 1992 Medicare cost reports.

Our review showed that ABC claimed unallowable G&A expenses totaling \$14,253,875. About 96 percent of these costs were allocated to the Medicare program by ABC. Medicare program regulations generally require that for costs to be allowable, the costs must be reasonable, necessary for the maintenance of the health care entity, and related to patient care. Our review found the following costs unallowable according to Medicare guidelines.

- Computer system - \$9,755,013 for externally developed computer software that was not yet operational was included in the 1992 cost reports. The Medicare guidelines provide that purchased computer software should be capitalized; depreciation is allowable, but only after the system is operational.
- Salary costs - \$1,760,943 for salary and related costs for personnel whose functions were not related to patient care or maintenance of the health care entity.
- Owner's compensation - \$383,217 in excess salaries and fringe benefits for the two co-owners as the Chief Executive Officer and the Chief Operating Officer. We believe the amounts of the co-owners' salaries are unreasonable because they are in excess of average salaries paid health care executives with comparable responsibilities.

- Leadership conference - \$1,020,312 paid for a conference in San Diego that covered many of the same topics that had been covered in other management meetings attended by many of the same people.
- Other unallowable costs - \$574,239 for marketing and promotional activities; \$212,443 for entertainment and gifts; \$72,500 for board of directors' fees; and \$475,208 for decorations, lobbying, and other unallowable costs.

We are recommending that the Health Care Financing Administration (HCFA) direct that the fiscal intermediary remove the \$14,253,875 of unallowable costs from ABC's 1992 cost reports.

On February 23, 1995, HCFA responded to a draft of this audit report. The HCFA stated that it generally agrees with the report findings and conclusions. Since the draft report was issued, claims processing for ABC has been transferred to another intermediary. The HCFA will provide a copy of the report to ABC's new intermediary for its review and comment on the proposed adjustment amounts. The HCFA's comments are presented as Appendix 11 to this report.

We previously provided a copy of a working draft of the audit results to ABC to obtain additional explanation and comment. In response primarily to unsupported costs totaling \$8.3 million, ABC provided a large volume of documentation. We are currently evaluating the documentation and will report on the unsupported costs separately.

We would appreciate your views and the status of any further action taken or contemplated on our recommendations within the next 60 days. If you have any questions, please call me or have your staff contact George M. Reeb, Assistant Inspector General for Health Care Financing Audits, at (410) 966-7104. Copies of this report are being sent to other interested Department officials.

To facilitate identification, please refer to Common Identification Number A-04-93-02067.

Attachments

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF HOME OFFICE
GENERAL AND ADMINISTRATIVE COSTS
CLAIMED BY
ABC HOME HEALTH SERVICES, INC.**



**JUNE GIBBS BROWN
Inspector General**

**MARCH 1995
A-04-93-02067**

EXECUTIVE SUMMARY

BACKGROUND

This report addresses general and administrative (G&A) expenses claimed by ABC Home Health Services, Inc. (ABC) under the Medicare program for Fiscal Year (FY) 1992. The G&A costs totaled \$52,835,406 for FY 1992. The G&A costs were allocated to the Home Health Agencies (HHAs) in the ABC chain and about 96 percent of the G&A costs were reimbursed by the Medicare program.

The Medicare program is administered by the Health Care Financing Administration (HCFA) with assistance under contracts from fiscal intermediaries, usually insurance companies. The intermediaries are responsible for making reasonable payments for services, serving as a channel for communication between HHAs and HCFA, and establishing safeguards against unnecessary payments.

Program regulations governing Medicare coverage of home health benefits are contained in title 42 CFR, part 413. Additional instructions and guidelines are contained in the HCFA publication 15-1 chapter 21.

OBJECTIVE

The objective of our review was to determine the allowability of G&A costs claimed by ABC in the 1992 Medicare cost reports.

SUMMARY OF FINDINGS

Our review showed that ABC claimed unallowable G&A expenses totaling \$14.3 million. About 96 percent of these costs were allocated to the Medicare program by ABC.

We previously provided a copy of a working draft of the audit results to ABC to obtain additional explanation and comment. In response primarily to unsupported costs totaling \$8.3 million, ABC provided a large volume of documentation. We are currently evaluating the documentation and will report on the unsupported costs separately.

Unallowable Costs

We identified \$14,253,875 that was unallowable according to Medicare guidelines. Medicare program regulations generally require that costs to be allowable must be reasonable, necessary for the maintenance of the health care entity, and related to patient care. These unallowable costs and the program guidelines are summarized below.

UNALLOWABLE COSTS

<u>Category of Cost</u>	<u>Amount</u>	<u>Report Page</u>
Computer System	\$ 9,755,013	4
Salary Costs	1,760,943	6
Owners' Compensation	383,217	7
Leadership Conference	1,020,312	8
Marketing & Promotional Activities	574,239	10
Entertainment and Gifts	212,443	11
Board of Directors' Fees	72,500	12
Decorations	53,662	13
Capitalized Equipment & Software	20,715	13
Lobbying	18,608	15
Other Unallowable Costs	<u>382,223</u>	15
Total	<u>\$14,253,875</u>	

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- o Computer system - \$9,755,013 for externally developed computer software that was not yet operational was included in the 1992 cost reports. The Medicare guidelines provide that purchased computer software should be capitalized rather than expensed; depreciation is allowable, but only after the system is operational.
 - o Salary costs - \$1,760,943 for salary and related costs for personnel who were not related to patient care or maintenance of the health care entity. Thirty-three ABC employees functioned in the capacity of lobbyists or were involved in patient solicitation activities. Medicare guidelines provide that costs relating to lobbying or patient solicitation are not reimbursable by Medicare.
 - o Owner's compensation - \$383,217 in excess salaries and fringe benefits for the two co-owners as the Chief Executive Officer (CEO) and the Chief Operating Officer (COO). We believe the amounts of these salaries (\$366,465 for the CEO and \$304,885 for the COO) are unreasonable in that they are

in excess of average salaries paid health care executives with comparable responsibilities.

- o Leadership Conference - \$1,020,312 paid for a conference in San Diego. The conference covered many of the same topics that had been covered in other management meetings. The San Diego conference and the other meetings were attended by many of the same people. These costs were not related to patient care, were not necessary for the operation and sound conduct of the institution and duplicated other costs.
- o Marketing and Promotional Activities - \$574,239 for services such as promotional consulting and items such as ABC refrigerator magnets, and ABC promotional pens.
- o Entertainment and gifts - \$212,443 for entertainment and gifts. Medicare guidelines provide that costs must be related to patient care and be necessary for the maintenance of the health care entity. These costs did not meet that criteria. For example, \$84,341 was for gourmet popcorn in custom tins for physicians. Some of the other expenses included golf caps, trophies, fees, and tees; mardi gras tickets; and Phantom of the Opera tickets.
- o Board of Directors' Fees - \$72,500 for board of directors fees. Five of the six directors were members of the co-owners' immediate family. In addition, five of the six received substantial salaries from ABC. The board meetings were usually held on ABC property during normal business hours; each attendee received \$2,500 per meeting.
- o Other unallowable costs - (\$475,208) These costs included \$47,775 for framing of 1,000 prints of "the Ugly Rock Theory", \$2,789 for luncheons with legislators, and \$686 for 98 bags of vidalia onions for out-of-state legislators.

RECOMMENDATION

We recommend that HCFA direct the fiscal intermediary to remove the \$14,253,875 of **unallowable** costs from ABC's 1992 cost reports.

On February 23, 1995, HCFA responded to a draft of this audit report. The HCFA stated that it generally agrees with the report findings and conclusions. Since the draft report was issued, claims processing for ABC has been transferred to another intermediary. The HCFA will provide a copy of the report to ABC's new intermediary for its review and comment on the proposed adjustment amounts. The HCFA's comments are presented as Appendix 11 to this report.

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INTRODUCTION

BACKGROUND

Title XVIII of the Social Security Act authorizes the Medicare program to provide medical benefits to individuals 65 years of age and older, and certain individuals under age 65 who are disabled or suffer from chronic kidney disease. The medical benefits include medical services provided to eligible beneficiaries in their homes by Medicare certified HHAs.

The Medicare program is administered by HCFA with assistance under contracts from fiscal intermediaries, usually insurance companies. Nine regional intermediaries are under contract with HCFA to administer home health benefits. The intermediaries are responsible for making reasonable payments for services, serving as a channel for communication between HHAs and HCFA, and establishing safeguards against unnecessary payments.

The Medicare guidelines require that Medicare payments to HHAs for services be the lesser of reasonable costs or customary charges. The HHAs are paid no less frequently than every 2 weeks based on estimated costs. Final costs are determined by the intermediary during desk reviews and field audits of annual cost reports submitted by the HHAs. The final settlement is limited to costs that the intermediary determines are reasonable and related to patient care.

According to the October 1993 and June 1994 Prospective Payment Assessment Commission reports, home health expenditures for Medicare beneficiaries totaled \$7.1 billion in FY 1992 for 132 million visits for about 6,000 HHAs. The Commission estimates that expenditures by 1996 will total \$18.6 billion.

The ABC Home Health Services, Inc. is a chain organization that includes a holding company, home office, 5 senior regional offices, 16 regional offices, and 32 individual providers comprised of 189 separate locations. Each component is required to file a cost report with the intermediary. The intermediary's records showed that ABC reported Medicare costs totaling \$196,626,190.

The G&A costs for the period January 1, 1992 through December 31, 1992 totaled \$52,835,406 after reclassifications and adjustments. The G&A costs included the operating expenses of the holding company, home office, senior regional, and regional offices. Although the G&A costs were not directly reimbursable by Medicare, the costs were allocated to the HHAs in the ABC chain and about 96 percent of the \$52,835,406 was reimbursed indirectly by the Medicare program.

Program regulations governing Medicare coverage of home health benefits are contained in title 42 CFR, part 413. Additional instructions and guidelines are contained in the HCFA publication 15-1 Chapter 21.

SCOPE

The objective of our review was to determine the allowability of G&A costs claimed by ABC in the 1992 Medicare cost reports.

We reviewed the unaudited FY 1992 Medicare cost reports of ABC's holding company, home office, 5 senior regional offices, and 16 regional offices. We traced judgmentally selected costs to the accounting records. We reviewed invoices, payroll records, and other financial documents to ensure the costs were claimed in compliance with the Medicare guidelines.

Our review focused primarily on those items which had the greatest risk of abuse or noncompliance with Federal regulations. The items of G&A costs selected for review totaled \$25,047,755.

Allowability of costs was determined based on the cost principles provided in the HCFA publication 15-1 chapter 21 and the Commerce Clearing House Medicare and Medicaid Guide. We also applied the basic Medicare cost principle--an expense must be necessary, reasonable, and related to patient care to be allowable--title 42 CFR section 413.9.

We previously provided a copy of a "working draft" of the audit results to ABC to obtain additional explanation and comment. In response primarily to unsupported costs totaling \$8.3 million, ABC provided a large volume of documentation. We are currently evaluating the documentation and will report on the related cost separately.

Our review did not include an evaluation of ABC's methodology for allocating G&A costs. We did not consider the internal control structure of ABC. We conducted substantive audit tests rather than relying on the internal control structure.

Our review was performed in accordance with generally accepted governmental auditing standards. Our field work started in June 1993 and was completed October 1994.

DETAILED RESULTS OF AUDIT

The ABC claimed G&A expenses totaling \$14.3 million that were, in our opinion, unallowable based on the Medicare guidelines or did not meet the test of reasonableness, was not necessary, or was not related to patient care.

UNALLOWABLE COSTS

<u>Category of Cost</u>	<u>Amount</u>	<u>Appendix</u>
Computer System	\$ 9,755,013	1
Salary Costs	1,760,943	2
Owners' Compensation	383,217	N/A
Leadership Conference	1,020,312	3
Marketing & Promotional Activities	574,239	4
Entertainment and Gifts	212,443	5
Board of Directors' Fees	72,500	6
Decorations	53,662	7
Capitalized Equipment & Software	20,715	8
Lobbying	18,608	9
Other Unallowable Costs	<u>382,223</u>	10
Total Unallowable	<u>\$14,253,875</u>	

MEDICARE PROVIDER REIMBURSEMENT REQUIREMENTS

Title 42 CFR 413.1 states that providers will be reimbursed the cost of providing services to Medicare beneficiaries. The implementing guidelines in HCFA Publication 15-1 Chapter 21 Section 2102.3 states in part that:

...costs not related to patient care are costs which are not appropriate or necessary and proper in developing and maintaining the operation of patient care facilities or activities. Such costs are not allowable in computing reimbursable costs....

In addition, section 2100 of HCFA publication 15-1 provides that all payments to providers must be based on the "reasonable cost" of services covered under title XVIII of the Act and related to the care of Medicare beneficiaries.

Medicare cost principles limit reimbursement to the costs that would be incurred by a reasonable, prudent and cost-conscious management. The Social Security Amendments of 1972 provided for, among other things, improvements in the Medicare, Medicaid, and Maternal and Child Health programs with emphasis on improvements in their operating effectiveness. In the legislative history of the amendments, the House Ways and Means Committee recognized "...that costs can vary from one institution to another as a result of variations in efficiency of operation, or the provision of amenities in plush surroundings" (House Report No. 92-231). Commenting on the causes of variations in costs, the Committee stated:

Health care institutions, like other entities in our economy, should be encouraged to perform efficiently, and when they fail to do so should expect to suffer the financial consequences. Unfortunately, a reimbursement mechanism that responds to whatever costs a particular institution incurs presents obstacles to the achievement of these objectives. It is believed that they can only be accomplished by reimbursement mechanisms that limit reimbursement to the costs that would be incurred by a reasonable prudent and cost-conscious management.

It is not the committee's view that if patients desire unusually expensive services they should be denied the services. However, it is unreasonable for medicare or medicaid (which are financed by almost all people in the country rather than the patient or community that wants the expensive services) to pay for it" (emphasis added).

Computer System

The ABC claimed unallowable costs of \$9,755,013 for development of a computer system as a cost of operations for FY 1992. The

guidelines state that externally developed computer software (systems) must be capitalized and depreciated over a minimum of 5 years. Alternatively, the provider may depreciate the software over the life of the hardware purchased at the same time. The guidelines allow providers to expense computer software that is internally developed. The ABC has treated the costs of their computer system as internally developed. However, we believe it was externally developed under contract with IBM. The unallowable computer system costs are summarized in Appendix 1.

Section 104.17 of HIM-15 states:

...if the software is purchased with computer equipment, it should be depreciated over the useful life of the hardware if the cost of the software is not separately stated. If the cost of the software is separately stated, or if the software is purchased independent of the hardware, it must be depreciated over a minimum of 5 years. The costs of internally generated computer software are expensed, rather than capitalized. For purposes of this section, internally generated computer software means software generated, in whole or in part, by staff internal to the provider. The use of outside consultants to assist the provider's staff in developing a systems change would not change the nature of any resultant software from internally generated to purchased (emphasis added).

The ABC expensed \$9,755,013 as if the system was internally developed. Our review showed that the system was not internally developed.

According to a lawsuit filed by ABC on October 1, 1993, in U.S. District Court in the Southern District of Georgia, ABC entered into a contract with IBM for the development of software which could be matched with appropriate hardware. In the litigation complaint, ABC stated that rapid growth required major changes in their information system, "...charges which ABC had neither the skill nor the expertise to make on its own." The complaint further states that "...on or about February 25, 1991, ABC entered into an agreement with IBM for the development of software which could be matched with appropriate hardware to perform the information processing functions and generate the reports ABC required."

The litigation documents show that the computer system was not internally generated by ABC and was not operational in 1992. In addition, IBM's "Answer and Counterclaims," filed in response to the civil litigation, raises questions as to whether the costs included in the 1992 Medicare cost reports were actually paid. According to IBM, ABC had not paid bills totaling more than

\$7 million as of the end of October 1993. The ABC claims that all except \$1.9 million of the amount accrued in 1992 was paid by the end of 1993.

We requested ABC officials to provide documentation supporting expenditures of \$9,755,013 classified on the cost report as costs of a computer system. Most of the cost (\$8.5 million) was for software and hardware provided by IBM. The ABC provided copies of contracts that were in effect during 1992, but documentation was not adequate to identify the cost claimed with the particular contract or to separately distinguish between services, software, and hardware.

We concluded that the costs of the computer system were unallowable costs of the 1992 cost reporting period. The system was not internally developed and was not operational in 1992. Furthermore, because \$1.9 million of the \$9.7 million had not been paid by the end of 1993, it is not reimbursable in 1992. In order for the \$1.9 million to be reimbursable in 1992, regulations require that it would had to have been paid by the end of 1993. Therefore, costs of the system would not be allowable as an expense of the period or capitalized and depreciated until the system becomes operational.

The ABC contends that the computer system was developed internally with assistance from IBM. We believe the statements ABC made in the law suit against IBM support our position that the software was externally developed.

Salary Costs

The ABC claimed \$1,760,943 for salary and related costs for personnel performing functions that were unallowable under Federal guidelines.

Section 2102.2 of HIM 15-1 provides that costs included in the cost report must be related to patient care and necessary for the maintenance of the health care entity. Sections 2139 and 2136.2 also provide that lobbying and solicitation of patients are unallowable activities.

The HCFA recently issued amplification on existing instructions (sections 2139) and stated that lobbying is a form of political activity that is not allowable. The HCFA also stated that the absence of prior explicit instructions related to these costs does not mean that the costs were allowable.

The HIM 15-1 Section 2113.2 states that:

Costs ... which are primarily directed towards patient solicitation are unallowable costs.... Visits made by HHA personnel to patients which have not yet been

referred to the HHA... in order to persuade the patient to request the HHA's services are considered patient solicitation, as would visits to physicians to obtain referrals.

Our review showed that 33 ABC employees (12 were former owners of HHAs purchased by ABC) were paid for duties that were not related to patient care nor were they necessary for the maintenance of the health care entity. With one exception (VP of Operations-MS), these employees functioned in the capacity of lobbyists or were involved in patient solicitation activities. The unallowable positions and the related costs are summarized in Appendix 2. The VP of Operations-MS was employed by ABC's Managed Services Division and therefore the salary was not allocable to Medicare.

In commenting on the working draft, ABC stated that these individuals were not functioning in the capacity of lobbyists or involved in patient solicitation activities. The ABC stated that their duties involved identifying community needs, representing providers at community forums, establishing ongoing relationships with physicians and the community, assuring that ABC is aware of various legislative enactments and regulatory requirements, maintaining communication with State agencies, attending conferences and meetings to obtain information on upcoming changes that might affect the operation of ABC and the provision of health care so that plans could be made to comply with them, educating legislators on home health issues generally, monitoring proposed changes in legislation, and general dissemination of information on home health. The ABC contends that the duties of these individuals are entirely consistent with the regulatory provisions related to patient care and necessity for the maintenance of the health care entity.

We disagree. These functions and activities cannot be separated or segregated from lobbying or patient solicitation activities. They are, therefore, in violation of Federal guidelines and regulations and, as a result, unallowable.

Owners' Compensation

In the 1992 cost report, ABC claimed a total of \$775,035 in salary cost for the ABC Chairman & CEO and the ABC President, COO. These costs included \$366,465 in salary for the CEO, \$304,885 in salary for the COO, and \$103,685 in related fringe benefits. We consider some of this compensation to be excessive.

Section 902.3 defines reasonableness as follows:

Reasonableness requires that the compensation allowance be such an amount as would ordinarily be paid for comparable services by comparable institutions

depending upon the facts and circumstances of each case. Reasonable compensation is limited to the fair market value of services rendered by the owner in connection with patient care.

Section 904 states that the reasonableness of a person's compensation is made by comparing it with the compensation paid to other individuals in similar circumstances.

The 1994 Hay Hospital Compensation Survey is the largest such survey in the health care industry and contains information on compensation practices in 1,036 hospitals and involves 384,000 health professionals as of July 1, 1994. According to the Hay Group Survey, the average compensation paid to a CEO/Administrator for all independent hospitals in the survey is \$200,000 per year. The average paid to the COO for the same category and time frames is \$139,400 per year.

Moreover, an August 1994 General Accounting Office (GAO) study concluded that in 1991, hospital executives received an average of \$129,000 in compensation for overseeing hospital operations.

The ABC contracted with a consultant to provide information on compensation levels for comparable executive positions in comparable organizations and industries. The consultant concluded that the compensation of ABC executives, including the co-owners was reasonable. Although ABC provided us with a summary of the consultant's analysis, we were not provided with sufficient detail to enable us to evaluate the analysis.

In view of the Hay Hospital Compensation Survey and the recently issued GAO study, we believe the compensation of ABC's owners is excessive. We believe HCFA should direct the intermediary to remove \$383,217 in excess owners' compensation from ABC's 1992 cost reports. This represents \$166,465 (\$366,465 - \$200,000) in excess compensation for the CEO and \$165,485 (\$304,885 - \$139,400) in excess compensation for the COO. Our calculation of excess owners' compensation includes fringe benefits of 15.4442 percent (\$51,267) on excess salaries of \$166,465 and \$165,485.

Leadership Conference

The 4th annual ABC Leadership Conference was held November 30, 1992 through December 4, 1992, in San Diego, California at a cost of \$1,020,312. These costs were not related to patient care; they were not necessary for the operation and sound conduct of the institution; and they duplicated other costs in violation of the prudent buyer concept. The Leadership Conference costs are summarized in Appendix 3.

According to ABC's Audit Liaison, the Leadership Conference "...gives corporate personnel a chance to interact with field personnel. Leadership Conferences are held to review the prior year's goals and determine if they were met."

Our review showed that, prior to the Leadership Conference, ABC held several management meetings throughout the year (Spring management meeting, Summer management meeting, Fall management meeting,

Strategic Planning meeting and monthly Senior VP meetings); the approximate cost of these meetings was \$82,113. These management meetings covered many of the same topics that were also covered at the Leadership Conference and many of the same ABC personnel attended. Presumably, the Leadership Conference topics could have been covered in one of the other meetings. Accordingly, the \$1,020,312 represents unreasonable costs that exceed what a prudent and cost-conscious buyer would have incurred. In addition, the Leadership Conference did not relate to patient care; nor was it necessary for the maintenance of the health care entity.

The ABC agreed that the cost (\$16,863) of alcoholic beverages at the Leadership Conference was not allowable. However, in commenting on the working draft, ABC stated that the Leadership Conference is a once-a-year gathering designed to bring together all levels of management as well as those administrators directing the caregivers in the field for purposes of information sharing, employee motivation, and training. The ABC stated that this conference is a once-a-year opportunity to gather together the administrators from the provider agencies all over the country, giving them an opportunity to share experience and knowledge. In addition, it brings together top-level management and administrative staff at the Holding Company/Home Office level with first line supervisors (administrators and assistant administrators) at the agency/provider level. The conference also permits the newer administrators in the field to meet the people from the Holding Company who handle purchasing, accounts payable, accounts receivable, payroll, quality improvement/ utilization review, budget and planning as well as the senior accountants. The management meetings held throughout the year included only the senior level and regional level of management.

LEADERSHIP CONFERENCE TOPICS

ABC's computer systems
ABC's 401(k) Plan
Managing Without Interference
Strategic Planning
Legislative Affairs
Total Quality Management

These meetings were held by region rather than company-wide, except for one semiannual management meeting held in Brunswick.

However, it is Office of Inspector General's (OIG) position that these management meetings covered many of the same topics that were also covered at the Leadership Conference and many of the same ABC personnel attended. Prior to the Leadership Conference, ABC held several management meetings throughout the year (Spring Management Meeting, Summer Management Meeting, Fall Management Meeting, Strategic Planning Meeting and monthly Senior VP meetings). These management meetings covered many of the same subjects covered by the Leadership Conference and could and should have been designed to provide the appropriate information to the appropriate levels of the organization. Accordingly, we continue to believe that these costs were not necessary for the operation and sound conduct of the institution or related to patient care and duplicated other costs in violation of the prudent buyer concept.

Marketing and Promotional Activities

The G&A costs claimed by ABC included \$574,239 for marketing and promotional activities that were unallowable under Federal guidelines. The marketing and promotional activities and costs are summarized in Appendix 4.

Medicare guidelines, HIM-15, Section 2102.2, provides that costs included in the cost report must be related to patient care and necessary for the maintenance of the health care entity. While it is the policy of HCFA and other Federal agencies to promote the growth and expansion of needed provider facilities, general advertising to promote an increase in patient utilization of services is not properly related to the care of patients.

None of the marketing and promotional activities were related to patient care nor were they necessary for the maintenance of the health care entity. They are therefore unallowable as Medicare costs.

The ABC stated, in commenting on the working draft, that these kinds of inconsequential items are common and accepted occurrences by home health providers and that virtually every HHA in the country has pens and pencils and other inconsequential items emblazoned with their name. The ABC contends that these sorts of activities are customarily and traditionally carried out by providers as part of an effort to promote a good public image and to make the community aware of their presence, and that intermediaries routinely allow the costs of such inconsequential giveaways. Concerning the item "Solicitation of patients and agencies" (\$12,175) ABC stated:

The item "Solicitation of patients and agencies" consists of payments to Aydloitte & Cartwright for newspaper recruiting ads. These ads related to acquiring home health agencies. The ABC will not pursue its reimbursement claim for these costs.

However, we do not agree with ABC that the remaining items and associated costs are either inconsequential or common and accepted practices. Marketing and promotional costs in excess of \$570,000 can hardly be considered inconsequential. Further, the costs of these activities are unallowable under Federal guidelines. Medicare guidelines require that costs claimed must be related to patient care and necessary for the maintenance of the health care entity. Activities designed to promote the growth and expansion of needed provider facilities are appropriate; however, general advertising to promote an increase in patient utilization of services is not properly related to patient care or necessary for the maintenance of the health care entity. We continue to believe that since the marketing and promotional activities were not related to patient care or necessary for the maintenance of the entity they are unallowable as Medicare costs.

Entertainment and Gifts

The G&A costs claimed included \$212,443 of entertainment/gifts that were unallowable under Federal guidelines. The entertainment/gift costs are summarized in Appendix 5.

Medicare guidelines, HIM-15, Section 2102.2, provides that costs included in the cost report must be related to patient care and necessary for the maintenance of the health care entity.

None of the entertainment or gifts were related to patient care; nor were they necessary for the maintenance of the health care entity and are therefore unallowable as Medicare Costs.

While not concurring that \$262 spent on theater tickets was unallowable, ABC, in its comments to the working draft, stated they would not pursue this item. They did not concur that the remaining \$212,181 spent for entertainment and gifts was unallowable. The ABC contends that these costs are allowable because they related either directly or indirectly to patient care or were necessary for the maintenance of the health care entity. The ABC contends that there is a connection between the cost of the entertainment and gifts and patient care. However, none of the items appear related. Thus, we continue to believe that these costs are unallowable.

Board of Directors' Fees

The G&A costs claimed by ABC included \$72,500 for board of directors' fees that were unreasonable. The board of directors costs are summarized in Appendix 6.

Medicare guidelines, HIM-15, section 2102.1, provides that:

...actual costs be paid to the extent they are reasonable is the expectation that the provider seeks to minimize its costs and that actual costs do not exceed what a prudent and cost-conscious buyer pays for a given item of service.

The ABC board of directors has six members; five are members of the owner's family, and one nonfamily member was an ABC employee. The owner's daughter was the only member of the board who did not also receive a salary from ABC. Each board member received \$2,500 for each meeting; the meetings were usually held during work hours and on ABC property.

In view of the fact that all but one of the board members received substantial salaries from ABC and inasmuch as the board meetings took place on ABC property during normal business hours, we consider the fees unreasonable and a violation of the prudent buyer concept.

The ABC, in commenting on the working draft stated that the report did not indicate that the Board of Directors' fees were out of line with directors' fees paid by comparable providers and that these fees should be combined with other compensation paid to the owners to determine whether the amounts paid to the owners in total are comparable to amounts paid by comparable providers. The ABC also stated that the fact that the meetings took place during business hours is not relevant and since members of the Board of Directors have additional responsibilities and liabilities beyond those imposed on any individual employee, it is necessary to compensate them for those obligations because they are not required to incur these responsibilities gratis.

We disagree. We did not question these fees on the basis of total compensation or a comparison to other providers but on the basis of reasonableness. Since all but one of the board members received substantial salaries from ABC and since the board meetings took place at ABC's offices during normal business working hours, we consider the fees to be unreasonable and a violation of the prudent buyer concept and therefore unallowable as Medicare costs.

Decorations

The G&A costs claimed by ABC included \$53,662 for office decorations that were unallowable under Federal guidelines. The decorations costs are summarized in Appendix 7.

Medicare guidelines, HIM-15, section 2102.2, provides that costs included in the cost report must be related to patient care and necessary for the maintenance of the health care entity.

None of the prints, plants, or flowers were related to patient care; nor were they necessary for the maintenance of the health care entity and are therefore unallowable as Medicare costs.

The ABC disagreed that the \$53,662 in office decorations was unallowable. In their response to the working draft, they considered most of the cost (\$48,000 for framing 1,000 prints of the "Ugly Rock Theory") was for the promotion of the company philosophy. They state that incurring such cost is a common practice in business.

While promoting the company philosophy and decorating the walls may be a common practice in business, we believe that these costs are not related to patient care and are thus unallowable according to the Medicare guidelines.

Capitalized Equipment and Software

The G&A costs claimed by ABC included \$20,715 for office equipment and computer software that should have been capitalized in accordance with Medicare guidelines. The equipment and software expenses are summarized in Appendix 8.

Medicare guidelines, HIM-15, Section 108.1, provides that:

If a depreciable asset has at the time of acquisition an estimated useful life of at least 2 years and a historical cost of at least \$500, its cost must be capitalized, and written off ratably over the estimated useful life of the asset...

Section 104.17 of HIM-15 states:

...if the software is purchased with computer equipment, it should be depreciated over the useful life of the hardware if the cost of the software is not separately stated. If the cost of the software is separately stated, or if the software is purchased independent of the hardware, it must be depreciated over a minimum of 5 years.

The ABC's G&A cost should have included only the depreciation applicable to the office equipment and not the total cost of that equipment. The ABC's treatment of these costs caused the G&A costs to be overstated by \$20,714.85 (\$21,434.45 less allowable depreciation of \$719.60).

The ABC agrees that the \$523.69 for the slide projector, the \$3,937.50 for the X-Rite #706 Shrink Wrap System, the \$2,240.70 for the Heavy Duty Jogger Bracket and Challenge Paddywagon and \$511 for a monitor should have been capitalized. In responding to our working draft, ABC provided evidence to support a year-end adjustment to their records to reflect capitalizing and depreciating the \$3,937.50 for the Shrink Wrap System and \$511 for the monitor. There was no evidence to suggest that the \$523.69 for the slide projector and \$2,240.70 for the Jogger Bracket had been adjusted in order to capitalize these items.

The ABC did not agree that the cost of the Lotus software should be capitalized. They contend it is only because the sales tax was added to the cost of each package which caused the unit price to exceed the capitalization guidelines of \$500. We disagree with the assertion that the sales tax should not be included in the cost of an asset to be capitalized. Sales tax, as well as any other associated cost, such as shipping charges, installation costs, etc., should be added to the cost of the asset when determining the amount to be capitalized. In this case, each Lotus software package costing \$514 (the aggregate totaling \$7,732) should be capitalized and depreciated over its useful life.

The ABC also did not agree that a "UPS Ground Saver Chip" (\$750) and a "Shipping Weight Chip" (\$300) for Pitney Bowes equipment should be capitalized. The ABC contends that the cost of the "UPS Ground Saver Chip" should be charged to Maintenance and Repairs (account 7415) and the cost of the "Shipping Weight Chip" (\$300) does not meet the capitalization threshold \$500. We agree that the \$300 for the "Shipping Weight Chip" does not need to be capitalized under Medicare guidelines. However, the cost of the "UPS Ground Saver Chip" (\$750) does meet the capitalization criteria and should be depreciated over the asset's useful life since the chip is neither maintenance nor repair to equipment but enhancements to existing equipment.

In summary, ABC has recognized that some cost should have been capitalized. We believe that the cost report is still overstated by \$20,714.85 (\$21,434.45 less allowable depreciation of \$719.60).

Lobbying

The G&A costs claimed by ABC included \$18,608 for lobbying activities that were unallowable under Federal guidelines. The lobbying expenses are summarized in Appendix 9.

Medicare guidelines, HIM-15, Section 2102.2, provides that costs included in the cost report must be related to patient care and necessary for the maintenance of the health care entity. In addition, HCFA recently issued amplification on existing instructions and stated that lobbying is a form of political activity that is not allowable. The HCFA also stated that the absence of prior explicit instructions related to these costs does not mean that the costs were allowable.

None of the lobbying activities were related to patient care; nor were they necessary for the maintenance of the health care entity and are therefore unallowable as Medicare costs.

The ABC did not agree that the \$18,608 in lobbying costs was not allowable. In commenting on the working draft, ABC stated that the "luncheon with legislators" and the "press event" with Senator Sasser were part of ABC's community education function and served to disseminate information for the advancement of patient care and contributed to the good public image of the company. The ABC contends that these activities were not intended to influence the passage of legislation or lobby Senator Sasser. The ABC did not comment on the 98 bags of vidalia onions for out-of-State legislators.

Lobbying activities are unallowable under Federal guidelines. Medicare guidelines provide that costs must be related to patient care and necessary for maintenance of the health care entity. None of these lobbying activities were related to patient care or necessary for the maintenance of the health care entity. Therefore, we continue to believe they are unallowable as Medicare costs.

Other Unallowable Costs

The G&A costs claimed by ABC included \$382,223 for "other expenses" which were not related to either patient care or necessary for the maintenance of the health care entity. The other expenses are summarized in Appendix 10.

None of the expenses were related to patient care; nor were they necessary for the maintenance of the health care entity and are therefore unallowable as Medicare costs.

In commenting on the working draft, ABC stated that, for the most part, it believes these costs are allowable although it did agree that, in some instances, the costs should be allowed in a prior

or subsequent year. The ABC also stated that, in a few instances, the OIG is correct that the costs should be reclassified to other entities and that these errors should be corrected. For example, ABC agreed that the \$26,054 were prior year costs and the \$14,629 were duplicate payments.

We continue to believe that none of these costs were related to patient care or necessary for the maintenance of the health care entity in 1992 and are therefore unallowable as Medicare costs.

CONCLUSIONS AND RECOMMENDATIONS

Our review showed that ABC included unallowable G&A costs in the Medicare home office cost reports. Although home office costs were not directly reimbursable by Medicare, the costs were allocated to the HHAs in the ABC chain and about 96 percent of the G&A costs were reimbursed indirectly by the Medicare program.

We recommend that HCFA direct the fiscal intermediary to remove the \$14,253,875 of **unallowable** costs from ABC's 1992 cost reports.

HCFA'S RESPONSE

On February 23, 1995, HCFA responded to a draft of this audit report. The HCFA stated that it generally agrees with the report findings and conclusions. Since the draft report was issued, claims processing for ABC has been transferred to another intermediary. The HCFA will provide a copy of the report to ABC's new intermediary for its review and comment on the proposed adjustment amounts. The HCFA's comments are presented as Appendix 11 to this report.

REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992

Unallowable Computer System Costs

<u>Vendor - Services</u>	<u>Amount</u>
IBM - software & hardware	\$8,524,615
BH&A - technical writers	530,720
Working Systems - programming	154,381
Aguilar - RPG coding/programming	123,215
Tri Quan - programming	111,782
Foresight Systems - programming	77,723
Dracs - programming	65,865
ICS Systems Services - programming	59,046
Computer Task Group - programming	55,514
CJ - programming	36,941
Consultants' travel costs	<u>15,211</u>
TOTAL	<u>\$9,755,013</u>

REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992

Unallowable Salary Costs

<u>Title</u>	<u>Amount</u>
17 Directors of Community Affairs	\$ 610,668
6 Associate Directors of Governmental Affairs	264,538
2 Field Management Development Personnel	159,882
1 Vice President of National Regulatory Affairs	113,632
2 Vice President of Operations	81,097
1 Vice President - State Regulator	80,818
1 Administrative Assistant to the CEO	58,474
1 Media Director for one month	<u>6,614</u>
Total Salary Costs	\$1,375,723
Fringe Benefits at 15.4442%	212,470
Related Travel & Meals Expenses	<u>172,750</u>
Total Salary Costs & Related Expenses	<u>\$1,760,943</u>

**REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992**

**Unallowable Salary Costs
(fringe benefits not included)**

Directors of Community Affairs

The ABC employed seventeen Associate Directors of Community Affairs at a cost of \$610,668; salary payments ranged from \$3,691 to \$95,831. The duties of an Associate Director of Community Affairs included establishing and maintaining relationships with referral sources. While it is true that Medicare guidelines allow HHAs to conduct education and liaison activities in order to educate physicians and other health care providers about the range of home care services available, there is no provision for establishing and maintaining working relationships. In our opinion, these activities can be construed as patient solicitation.

Associate Directors of Governmental Affairs

The ABC employed six Associate Directors of Governmental Affairs at a total cost of \$264,538; salaries ranged from \$10,110 to \$87,220. The duties included overseeing legislative activities impacting the industry and maintaining close contact with regulatory agencies. Our review of travel showed that these employees spent a significant amount of time in Washington, D.C. meeting with legislators. In our opinion, these activities are lobbying.

**REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992**

**Unallowable Salary Costs
(fringe benefits not included)**

Field Management Development Personnel

The ABC employed a Vice President Field Management Development and a Regional Director - Field Management Development at a total cost of \$159,882; one received \$74,552 and the other received \$85,329. Their duties included reviewing operations with regard to community impact/relations and referral source relations, identifying community health care needs, and monitoring community/State/national developments which may impact visit activity. In our opinion, these activities are related to patient solicitation and lobbying; both of which are unallowable.

Vice President of National Regulatory Affairs

The ABC's Vice President of National Regulatory Affairs salary totaled \$113,632. His duties included overseeing legislative activities impacting the industry and maintaining close contact with regulatory agencies. In our opinion, these activities constitute lobbying.

Vice President of Operations

The ABC employed two Vice Presidents of Operations whose salaries totaled \$81,097. The duties included planning, coordinating, organizing and directing activities of managed home care agencies. In 1990, ABC expanded its business line to provide home health management services to hospital-based HHAs (managed facilities). The ABC received \$3.8 million in revenues for these services. It is inappropriate to include the salary allocable to the management services line of business in the HHA Medicare cost report.

Vice President - State Regulator

The ABC's Vice President - State Regulator salary totaled \$80,818. His duties included overseeing legislative activities impacting the industry and maintaining close contact with regulatory agencies. Furthermore, in commenting in our working draft, ABC stated that this position was responsible for many state Medicaid activities. In our opinion, these activities constitute lobbying and are not related to patient care and therefore not allowable according to HIM 15-1 Section 2139 or are not allocable to Medicare because they relate to Medicaid.

**REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992**

**Unallowable Salary Costs
(fringe benefits not included)**

Administrative Assistant to the CEO

The salary of ABC's Administrative Assistant to the CEO totaled \$58,474. His duties included requesting the cooperation of various government agencies to promote health care improvements, keeping informed of legislature proposals, and keeping ABC in the fore front of community involvement and negotiation. This position required "the ability ... to work with politicians...." In our opinion, these activities constitute lobbying.

Media Director

The salary for ABC's Media Director for 1 month totaled \$6,614. His duties included designing and implementing electronic media systems to meet present and ongoing needs of the corporation. Our review of this employees travel showed that he filmed such subjects as rap singers, softball games and produced a short film entitled '15 Glorious Years' a history of ABC. In our opinion, none of these items are related to patient care.

Travel and Meals

The ABC's G&A cost included \$172,750 for travel and meals for the above listed employees.

REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992

Unallowable Leadership Conference Costs

<u>Category of Cost</u>	<u>Amount</u>
San Diego Marriott	
Guest Rooms	\$360,371
Alcoholic Beverages	16,863
Hospitality Bars/Reception	34,774
Reception	32,301
Catering	110,443
Misc. (security, phones, shipping, copies, etc.)	<u>12,527</u>
Total Marriott	\$567,279
Consultation/Planning	\$362,888
Speaking Fees	12,870
Airfare (not including ABC owned aircraft)	<u>77,275</u>
Total Conference Expense	<u>\$1,020,312</u>

REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992

Unallowable Marketing & Promotional Costs

<u>Category of Cost</u>	<u>Amount</u>
Promotional consulting	\$147,344
ABC "refrigerator" magnets - 142,835	38,969
ABC promotional pens - 131,023	37,568
ABC body and hand lotion - 88,272 containers	30,888
ABC sponges - 137,532	28,426
ABC umbrellas - 5,292	27,930
ABC mugs - 11,373	21,303
Campaign photo shoot	27,604
ABC earrings - 3,000 & cuff links - 99	21,243
Attache cases with gold imprint - 609	19,382
ABC monthly minders - 14,000	18,875
Prescription pad holders - 1,305	15,291
ABC literature holders - 5,196	15,024
ABC emery boards - 334,590	14,415
Solicitation of patients and agencies	12,175
ABC sewing kits - 50,000	11,550
ABC business card holders - 10,600	9,899
ABC T-shirts - 1,458	8,580
ABC jar openers - 19,672	6,301
ABC pencils - 40,318	4,381
ABC pocket first aid kits - 15,170	4,123
ABC combs - 25,000	4,001
ABC 12 quart coolers - 804	3,730
ABC fanny packs - 327	3,151
ABC travel folders with calculators - 105	2,967
ABC golf tees - 6,000	2,723
ABC house shaped paper clips - 12,000	2,065
ABC buttons "4 million visits in 1992" - 5,000	1,624
Sport jackets with ABC buttons - 8	1,510
ABC trade mark registration	1,238
Other miscellaneous items	<u>29,959</u>
 TOTAL	 <u>\$574,239</u>

REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992

Unallowable Entertainment & Gift Costs

<u>Category of Cost</u>	<u>Amount</u>
Gourmet popcorn in custom tins for physicians - 5,100	\$ 84,341
Christmas, birthday, sympathy & get well cards - 120,000	20,882
Dinnerware - thousands of items	14,861
Fall Benefit for Black Physicians	5,000
ABC cups - 40,000	6,039
Golf caps, trophies, fees, tees, and gift certificates	3,751
Cross pens for graduation gifts - 185	3,285
Mardi Gras tickets - 22	2,700
Banquet for medical school residents	2,679
Seafood Festival tickets - 250	2,500
Partners in Education banquets	1,200
Party for the Georgia Association of HHAs	1,039
Phantom of the Opera tickets - 7	262
Employee social functions and gifts	57,768
Miscellaneous items	<u>6,136</u>
TOTAL	<u>\$212,443</u>

REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992

Unallowable Board of Directors' Fees

<u>Board Member</u>	<u>Salary</u>	<u>Board Fees</u>
Owner	\$366,465	\$ 12,500
Owner's Wife	304,885	12,500
Owner's Son	58,474	10,000
Owner's Son	54,370	12,500
Owner's Daughter	0	12,500
Executive VP & Chief Admin.	166,285	<u>12,500</u>
TOTAL		<u>\$ 72,500</u>

REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992

Unallowable Decorations Costs

<u>Category of Cost</u>	<u>Amount</u>
Framing of 1,000 prints of "the Ugly Rock Theory"	\$ 47,775
Plants and flowers	4,189
Prints and pictures	<u>1,698</u>
TOTAL	<u>\$ 53,662</u>

REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992

Unallowable Equipment & Software Costs

<u>Category of Cost</u>	<u>Amount</u>
Equipment	\$ 6,658
Software (Lotus)	8,482
Computer monitors - 11	5,108
Office furniture	1,186
Allowable 1992 depreciation	<u>(719)</u>
TOTAL	<u>\$ 20,715</u>

REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992

Unallowable Lobbying Costs

<u>Category of Cost</u>	<u>Amount</u>
Luncheons with legislators	\$ 2,789
Senator Sasser's press event	2,473
98 bags vidalia onions for out-of-state legislators	686
ABC's travel for legislative meetings	<u>12,659</u>
TOTAL	<u>\$ 18,608</u>

REVIEW OF GENERAL AND ADMINISTRATIVE COSTS
AT ABC HOME HEALTH SERVICES, INC.
FOR 1992

Other Unallowable Costs

<u>Category of Cost</u>	<u>Amount</u>
Costs applicable to individual HHAs	\$ 38,908
Prior year costs	27,619
Legal retainer fees	25,000
Duplicate claims	54,386
Penalties and interest	24,730
Meals for non-ABC and ABC personnel not traveling	11,192
ABC's Management Services Division expenses	9,144
Donations to Moorehouse School of Medicine	7,500
Legal fees for Athens Business Center	6,930
California Homecare Coalition legal fees	4,660
ABC's Private Duty Division expenses	3,737
Subsequent year cost	143,282
Legal fees associated with loan to employee	1,421
Expenses for disallowed salaries	3,017
Other miscellaneous unallowable costs	<u>20,697</u>
TOTAL	<u>\$382,223</u>



DEPARTMENT OF HEALTH & HUMAN SERVICES

Health Care
Financing Administration

Memorandum

DATE FEB 23 1995

FROM Bruce C. Vladeck 
Administrator

SUBJECT Office of Inspector General Draft Report: "Review of Home Office General and Administrative Costs Claimed by ABC Home Health Services, Inc." (A-04-93-02067)

TO June Gibbs Brown
Inspector General

We reviewed the subject final report which identified \$14,253,875 in unallowable general and administrative costs claimed by ABC Home Health Services, Inc., in its 1992 Medicare cost reports. Our comments are attached for your review.

Thank you for the opportunity to review and comment on this report. Since the report was issued, claims processing for this provider has been transferred to Iowa Blue Cross. We believe that this audit will prove to be very useful to them in conducting their review/audit of ABC's fiscal year 1992 costs.

Attachment

Comments of the Health Care Financing Administration (HCFA)
on Office of Inspector General (OIG) Draft Report:
"Review of Home Office General and Administrative Costs
Claimed by ABC Home Health Services, Inc."
(A-04-93-02067)

OIG Recommendation

HCFA should direct Aetna to remove the \$14,253,875 of unallowable costs from ABC's 1992 cost reports.

HCFA Response

HCFA generally agrees with the report findings and conclusions. However, we cannot fully concur with the recommendation to direct ABC's intermediary to disallow \$14,253,875 of ABC's costs. Since the report was issued, claims processing for this provider has been transferred to Iowa Blue Cross. We are providing Iowa Blue Cross a copy of the draft report for their review and comment on the proposed adjustment amounts. The exact determination of the amount of any disallowance of ABC's fiscal year 1992 costs is entirely dependent upon the outcome of the intermediary's application of Medicare reimbursement policy in reviewing and settling the ABC providers' cost reports.