

**Memorandum**

Date AUG 19 1993

From Bryan B. Mitchell *Bryan Mitchell*  
Principal Deputy Inspector General

Subject Administrative Costs Claimed Under Part A of the Health Insurance for the Aged and Disabled Program - Blue Cross of Western Pennsylvania (A-03-90-02003)

To Bruce C. Vladeck  
Administrator  
Health Care Financing Administration

This is to alert you to the issuance on August 20, 1993, of our final report. A copy is attached.

During the period October 1, 1985 through September 30, 1989 Blue Cross of Western Pennsylvania (BCWP) claimed about \$57.5 million for administering the Medicare Part A program. The audit showed that as much as \$2.2 million of the costs claimed were unallowable.

The Health Care Financing Administration (HCFA) contracted with BCWP to administer the Medicare Part A program. Under the provisions of the contract, BCWP is required to receive, disburse, and account for Federal funds in making payments for services furnished to eligible Medicare beneficiaries. The BCWP's responsibilities also include determinations as to coverage of services and the reasonableness of charges, furnishing timely information and reports to HCFA, and maintaining records to ensure the correctness and verification necessary for the administration of the contract.

The BCWP is entitled to reimbursement of all authorized administrative costs claimed, provided that the provisions of the Medicare agreement have been met and that the costs were incurred in accordance with Federal regulations. The audit showed that about \$2.2 million of the claimed costs were not in accordance with Federal regulations. The unallowable costs consisted of:

- rental costs of \$1,159,389 which were claimed but not incurred;
- costs of \$347,178 for unspecified Productivity Investments projects that were not approved by HCFA;

- Purchase Service Agreement (PSA) costs of \$24,321 that were misclassified or based on estimated rather than actual costs; and
- cost offsets of \$687,640 known as complementary credits. The BCWP had not implemented the 1986 revisions to the Intermediary Manual which required contractors to identify complementary credits on a cost allocation basis and, as a result, understated the complementary credit due the Medicare program for Fiscal Years 1987 through 1989.

The BCWP agreed that PSA costs were overstated by \$24,321 and that it had understated its complementary credits by \$171,348. The BCWP did not agree to make the additional financial adjustments totaling \$2,022,859. The HCFA agreed with the findings and recommendations contained in this report.

For further information, contact:

Thomas J. Robertson  
Regional Inspector General  
for Audit Services, Region III  
(215) 596-6744

Attachment

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**ADMINISTRATIVE COSTS CLAIMED  
UNDER PART A OF THE  
HEALTH INSURANCE FOR THE AGED  
AND DISABLED PROGRAM**

**BLUE CROSS OF WESTERN  
PENNSYLVANIA**



AUGUST 1993    A-03-90-02003



DEPARTMENT OF HEALTH & HUMAN SERVICES

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Our Reference: Common Identification Number A-03-90-02003

Ms. Marilyn Koch  
Vice President  
Blue Cross of Western Pennsylvania  
Fifth Avenue Place  
Pittsburgh, Pennsylvania 15222

Dear Ms. Koch:

Enclosed for your information and use are two copies of an HHS/OIG Office of Audit Services final audit report titled **Review of Administrative Costs Claimed Under Part A Of The Health Insurance For The Aged And Disabled Program**. Your attention is invited to the audit findings and recommendations contained in the report.

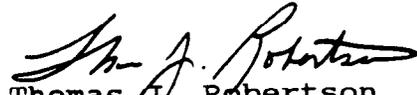
Final determination as to the actions to be taken on all matters will be made by the HHS action official named below. The HHS action official will contact you to resolve the issues in this audit report. Any additional comments or information that you believe may be bearing on the resolution of this audit may be presented at that time. Should you have any questions, please direct them to the HHS official named below.

In accordance with the principles of the Freedom of information Act (Public Law 90-23) , HHS/OIG Office of Audit Services reports issued to the Department's grantees and subcontractors are made available, if requested 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 section 5.71 of the Department's Public Information Regulation, dated August, 1974, as revised.)

Page - 2 Ms. Marilyn Koch

To facilitate identification, please refer to the referenced common identification number in all correspondence relating to this report.

Sincerely yours,



Thomas J. Robertson  
Regional Inspector General  
for Audit Services

Enclosures

Direct Reply to:

Mr. Dennis Carrol  
Associate Regional Administrator  
Division of Medicare  
Health Care Financing Administration  
Region III

## SUMMARY

Blue Cross of Western Pennsylvania (BCWP) claimed \$57,470,594 on Final Administrative Cost Proposals (FACPs) for the period October 1, 1985 through September 30, 1989 for work related to processing Part A Medicare claims. Our review of BCWP's accounting records revealed that most of the costs claimed were allowable. We noted, however, three problems associated with Medicare Part A costs that resulted in excess Medicare claims totaling \$2,218,528.

One problem was that BCWP, contrary to Federal regulations, did not allocate rental credits to Medicare to offset rental expenses. The BCWP received credit equal to all of the rental costs for its corporate offices throughout Fiscal Year (FY) 1988 and for the first 6 months in FY 1989. These credits were not allocated to Medicare and, as a result, Medicare was overcharged \$1,159,389.

The second problem was that BCWP allocated \$371,499 of unallowable costs to Medicare. This consisted of \$347,178 for unspecified Productivity Investment projects which were not approved by the Health Care Financing Administration, and \$24,321 for an overstatement of expenses on a Purchase Service Agreement.

The third problem involved cost offsets known as complementary credits. These are credits due Medicare for work performed for the mutual benefit of Medicare and the complementary insurance program operated by BCWP. We found that BCWP had not implemented the 1986 revisions to the Intermediary Manual which required it to identify complementary credits on a cost allocation basis. Instead, BCWP determined complementary credits utilizing a standard rate for each claim transferred. Based on our calculations, we estimate that BCWP overcharged the Medicare program a total of \$687,640 for FYs 1987 through 1989.

We are making procedural recommendations to BCWP to correct the deficiencies that we noted in this review. We are also recommending that BCWP reduce its FY 1986 through FY 1989 FACPs by a total of \$2,218,528.

On May 13, 1993, BCWP responded to a draft of this report in which it commented on the findings and recommendations and requested an audit exit conference. Based on BCWP's response, we have made certain changes to this report. We have summarized BCWP's response in this report and have provided additional comments, as appropriate. We have also included BCWP's response in its entirety as an appendix to this report. An exit conference was held on July 1, 1993.

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**Appendix - BCWP's Response Dated May 13, 1993**

# INTRODUCTION

## BACKGROUND

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

Medicare is administered by the Health Care Financing Administration (HCFA). Under an agreement with the Secretary of the Department of Health and Human Services (HHS), Blue Cross Association (BCA) participates in the administration of the Medicare Part A program. Blue Cross of Western Pennsylvania (BCWP), under a sub-contract with BCA, is responsible for the receipt, review, audit, and payment of Medicare Part A claims submitted by the providers it services.

The BCWP is entitled to reimbursement for the allowable administrative costs incurred in carrying out its responsibilities under the Medicare subcontract with BCA. From October 1, 1985 through September 30, 1989, BCWP incurred and claimed administrative expenses of \$57,470,594 for processing Medicare Part A claims. As shown below, BCWP did not exceed its total approved budget in any of the 4 years reviewed

RECONCILIATION OF COSTS CLAIMED TO BUDGET			
<u>Fiscal Year</u>	<u>Budgeted Costs</u>	<u>Claimed Costs</u>	<u>Over (Under)</u>
1986	\$12,598,100	\$12,499,968	(\$98,132)
1987	13,271,435	13,270,937	( 498)
1988	15,183,580	15,183,580	0
1989	<u>16,967,900</u>	<u>16,516,109</u>	<u>(451,791)</u>
Total	<u>\$58,021,015</u>	<u>\$57,470,594</u>	<u>(\$550,421)</u>

Included in the costs claimed by BCWP are the costs incurred under four Purchase Service Agreements (PSA). The PSAs were entered into with two former intermediaries, Capital Blue Cross (CBC), Blue Cross of Northeastern Pennsylvania (BCNEPA), and Shared Services Center (SSC), a data processing facility owned jointly by CBC and BCNEPA. Under a Memorandum of Advance Understanding with the Secretary of HHS, in August 1984, BCWP

assumed the Medicare Part A responsibilities of these former intermediaries and was granted the authority to enter into service agreements with them. The agreements provided that CBC, and BCNEPA, in essence, would continue to operate in the same capacity for their Medicare beneficiaries and providers. The BCWP agreed to reimburse them for all allowable expenses, while the costs of these agreements were included in BCWP's Medicare budget.

Under the agreements, CBC and BCNEPA provided services such as claims processing, beneficiary services, provider relations, provider payments, and medical and utilization reviews. The CBC and BCNEPA were required to maintain performance levels to meet HCFA's CPEP-Part A requirements. Reimbursement for expenses incurred under the PSA was on the basis of reasonable cost of administration as defined in the Law, Regulations and General Instructions for Intermediaries.

During Fiscal Years (FY) 1985 through 1989, CBC, BCNEPA, and SSC submitted to BCWP expenditure reports with total costs of \$7,058,016, \$3,834,703, and \$7,491,163 respectively. Costs under these agreements represent 32 percent of the total \$57.5 million claimed by BCWP on its Medicare Part A Final Administrative Cost Proposals (FACPs).

## **SCOPE OF AUDIT**

Our audit was made in accordance with generally accepted government auditing standards. Our primary objective was to determine whether BCWP's FACPs for FYs 1986 through 1989 presented fairly the allowable costs of administration in conformity with the reimbursement principles contained in Chapter 1, Part 31 of the Federal Acquisition Regulations (FARs), as interpreted and modified by the Medicare contract, and the Intermediary Manual published by HCFA.

We tested expenditures, addressed specific concerns brought to our attention by HCFA, and reviewed manual revisions used to reconcile Medicare booked costs to Medicare claimed costs. We also held discussions with personnel from BCWP, CBC, BCNEPA, SSC and officials from HCFA Regional Office.

As part of our review, we reconciled claimed costs for each PSA to the respective books and records, and verified expenses by reviewing canceled checks, facilities' leases, invoices, and other support documentation for selected cost categories such as pension expenses, subcontract expenses, and consulting fees. Other than our adjustments for overstated expenses of \$24,321 for SSC, our review did not identify any material discrepancies with costs claimed under the PSAs.

We also reviewed the accuracy, reasonableness and allowability of Medicare complementary credits computed by BCWP. Because Medicare guidelines for computing these credits were revised in May 1986, we limited our review of complementary credits to FYs 1987 through 1989.

Our audit dealt primarily with allowability of costs. As part of our examination, however, we made a study of BCWP's system of internal controls regarding the management of Federal funds to the extent we considered necessary to evaluate the system. We did not audit either the effectiveness or efficiency of BCWP's operation. Other than the issues discussed in the FINDINGS AND RECOMMENDATIONS section of this report, we found no instances of noncompliance with applicable laws and regulations. With respect to those items not tested, nothing came to our attention to cause us to believe that the untested items were not in compliance with applicable laws and regulations.

Our review was performed during the period June 1990 through August 1992 at BCWP's corporate offices in Pittsburgh, Pennsylvania and the respective headquarters of CBC, BCNEPA, and SSC, located in Harrisburg and Wilkes Barre, Pennsylvania. An exit conference was conducted with BCWP officials on July 1, 1993.

## **FINDINGS AND RECOMMENDATIONS**

### **UNALLOWABLE COSTS ALLOCATED TO MEDICARE**

Our review identified \$1,530,888 of unallowable claimed costs allocated to the Medicare program. This amount consists of:

- \$1,159,389 for rental costs that were claimed but not incurred;
- \$347,178 for unspecified Productivity Investment (PI) projects which were not approved by HCFA.
- \$24,321 associated with an overstatement of expenses on the PSA.

### **Rental Credits Not Allocated to Medicare**

The BCWP's FY 1988 and 1989 FACPs included expenditures for space costs amounting to \$579,367 and \$1,078,923 associated with rental costs of BCWP's new corporate headquarters, Fifth Avenue Place (FAP). The BCWP occupied the FAP in January 1988. Our review showed that BCWP received credits against the rent expenses for all of FY 1988 and up to 6 months in FY 1989. The

BCWP, however, did not allocate the credits to the Medicare program as required by Section 31-201.5 of the FARs. As a result, the rental expenses claimed on the FACPS were overstated by \$1,159,389 (\$579,367 in FY 1988 and \$580,022 in FY 1989)

### **FAP Rental Agreement**

The BCWP entered into a Bond Lease contract with Jenkins-Empire Associates (JEA) for the rental of office space at FAP, for a lease term of 29 years and 11 months, commencing in January 1988. The BCWP also entered into a Master Agreement which stipulated that JEA, as lessor, would make advance rent payments to the trustee of the building on behalf of BCWP during the first 12 months of each occupancy period or phase. The BCWP would have no obligation to pay basic rent during this rent-free period.

The Master Agreement provided for an occupancy schedule over six phases. The six phases represented successive occupancy dates for identified floors of the building. Rental payments for each phase were not due from BCWP for 12 months after the date of occupancy, as shown in the following examples.

Phase One occupancy for floors number 6, 7, and 8, began on January 1, 1988. Rental payments from BCWP for Phase One were not due until January 1, 1989.

Phase Two occupancy for floors number 9, 10, and 11, began on February 1, 1988, and the rental payments from BCWP were not due until February 1, 1989.

Phase Six occupancy for floors number 3, 4, 30, and, 31, began on June 1, 1988, and rental payments from BCWP were not due until June 1, 1989.

In defining allowable costs, the FARs state that costs must be incurred and that the Federal Government is entitled to its share of any credits and rebatements. FARs 31.201-1 defines the total cost of a contract as:

*... the sum of the allowable direct and indirect costs allocable to the contract, incurred or to be incurred, less any allocable credits..."*

Section 31.201-5 of the FARs defines credits as:

*The applicable portion of any income, rebate, allowance or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund.*

In computing the rental expense, BCWP did not offset the credit on the FACPs as required by FARs. Instead BCWP amortized the total cost of the lease over the lease term. The amortized payments were booked by BCWP and allocated to the Medicare program. As a result, the FYs 1988 and 1989 rental costs were overstated by \$579,367 and \$580,022 respectively.

### **Prior Approval for Rental Costs**

The BCWP's annual rental expense for the FAP, after the free period, will be in excess of \$8.5 million. Based on the 1989 Medicare Full Time Equivalent ratio of 11.85 percent, the Medicare allocation of these costs will exceed \$1 million per year, and requires HCFA's prior approval.

Article XIV of the Medicare contract requires an intermediary to obtain written approval from the Secretary prior to subcontracting for the lease of real property when the estimated cost to Medicare shall exceed an established threshold limit amount. For intermediaries with a fiscal year budget over \$10 million (BCWP meets this requirement), the threshold amount is \$500,000 allocable to Medicare.

The estimated rental costs to the Medicare program of \$1 million exceeds the HCFA threshold amount of \$500,000, but BCWP had not sought or obtained HCFA's approval prior to entering the FAP lease agreement. The HCFA regional officials were not provided the opportunity to review the lease and to make a determination as to whether the increased costs would benefit the Medicare program.

### **Productivity Investment Projects**

During our audit period, BCWP allocated to Medicare \$3.1 million for PI projects. Our review showed that \$347,178 of these costs were incurred for unspecified PI projects that were not approved by HCFA. As a result, the \$347,178 is unallowable for Medicare reimbursement.

The HCFA authorizes intermediaries to perform special PI projects that are outside the realm of normal processing of Part A claims. The PI projects are reimbursed through the FACPs. Since PI projects are not included in the regular budget process, the projects and the budget for the projects must be approved by HCFA.

On it FY 1986 FACP, BCWP claimed \$347,178 for unspecified PI projects. Our review of BCWP's files and HCFA's approved budgets as well as discussions with HCFA staff revealed that these projects were not approved by HCFA.

## **PSA Costs Overstated**

Our review of the costs claimed under the PSAs revealed that the FY 1989 costs were overstated by \$24,321. In claiming costs for FY 1989, SSC reported estimated costs rather than actual expenses which resulted in an overstatement of \$8,712. In addition, SSC also included an expense of \$15,609 that was misclassified and should have been charged to another customer.

## **Conclusions and Recommendations**

Our review of BCWP's costs for FYs 1986 through 1989 showed that BCWP allocated to the Medicare program unallowable costs of \$1,159,389 associated with rental costs for leased EDP equipment, \$347,178 for PI projects which were not approved by HCFA or exceeded the approved HCFA budget, and \$24,381 associated with an overstatement of expenses on a PSA.

We, therefore, recommend that BCWP:

1. Provide HCFA with all appropriate information relative to the FAP agreement so that HCFA can determine if BCWP should allocate rental costs of over \$1 million annually for the FAP to the Medicare program.
2. Obtain HCFA approval for all projects that are not mandated by HCFA.
3. Reduce the FY 1988 FACP by \$579,367 and the FY 1989 FACP by \$580,022 for rental costs claimed but not incurred.
4. Reduce the FY 1986 FACP by \$347,178 for PI projects not approved by HCFA.
5. Reduce the FY 1989 FACP by \$24,321 for overstated costs on the PSA with SSC.

## **BCWP Response and Office of Audit Services Comments**

In its response, BCWP agreed to provide HCFA with all pertinent information pertaining to the lease of FAP, and to reduce the FY 1989 FACP by \$24,321 because of overstated costs on the PSA with SSC. The BCWP disagreed with the remaining recommendations.

Based on BCWP's response, we have made changes to this section of the report. As shown below, we believe that the recommendations contained in this final report should be implemented by BCWP.

The BCWP did not agree to reduce the FYs 1988 and 1989 FACPs by a total of \$1,159,389 for rental costs claimed but not incurred. The BCWP believes that an equitable share of the rental credit has been allocated to the Medicare program. The allocation of the credit is reflected by the inclusion of the rent free period in determining the total costs of the lease. The annual rental expense is lowered by the inclusion of the rent free period in the calculation of the lease term.

We are aware that BCWP has allocated the rental credits to future periods thereby reducing the future allocations of rental costs to the Medicare program. However, in our opinion, this method may result in an inequitable allocation of costs to the Medicare program. Our review of BCWP allocation methodology revealed three inequities for the Medicare program.

- First, in order for the Medicare program to fully share in the rental credits, BCWP must remain a Medicare contractor until the year 2019. This may in fact be the case, however, Medicare contracts are renewed annually and there is no guaranty that BCWP will remain a contractor for that period of time.
- Second, BCWP assumes that the Medicare space allocation will not decrease over the next 30 years. A decrease in Medicare space allocation would result in an inequitable distribution of the rental credit to the Medicare program.
- Third, the reduced rental cost to be allocated to the Medicare program does not take into consideration the future value of the funds received from the Medicare program in FYs 1988 and 1989 when costs were not incurred. In effect, under BCWP's methodology, the Medicare program has provided BCWP with a 30 year interest free loan of \$1,159,389, the repayment of which is contingent upon BCWP remaining a Medicare contractor and allocating the same amount of space to the Medicare program until the year 2019.

In light of the above and the fact that the costs were never incurred, as required by FARs Section 31.201-1, we believe that these rental costs are unallowable for allocation to the Medicare program.

The BCWP stated that the audit report correctly identifies unspecified PI projects totaling \$347,178 as being claimed on its FY 1986 FACP. The BCWP stated that HCFA did not approve or pay more than the total claimed on the FACP and that this will have to be reconciled between BCWP and HCFA on the closing

agreement for this audit report. The BCWP also stated that it had always requested approval for PIs from HCFA and will continue to do so.

We note that BCWP did not present any documentation pertaining to the allowability or the nature of these PI costs. Furthermore, we found no documentation at either BCWP or at HCFA to demonstrate that the unspecified PI projects were approved by HCFA. Therefore, we believe our recommendations regarding PI projects remain valid. Should BCWP provide additional documentation to HCFA during the audit settlement process, we will gladly assist HCFA in reviewing the documentation for allowability.

## **COMPLEMENTARY CREDITS**

The BCWP reported complementary credits of \$535,904 on the FACPs for FYs 1987, 1988 and 1989 (\$171,637, \$184,914, and \$179,353, respectively) based on a standard rate of \$0.25 for every Medicare claim transferred to the complementary insurance program. This method was not in compliance with revised Medicare guidelines which required a full cost allocation for any routine transfer of information.

Since the revised Medicare guidelines were not implemented, there was no assurance that BCWP was paying its fair share of the cost of activities that benefitted both Medicare and its complementary insurance program. To determine if BCWP's complementary insurance program was paying its fair share of these costs, we recomputed the complementary credits on the basis of cost allocation as required by the revised Medicare guidelines. We determined that BCWP had understated the Medicare complementary credits by \$687,640 in FYs 1987 through 1989.

Complementary credits to Medicare result from Medicare sharing claimant data with a complementary insurance program. The BCWP operated a complementary insurance program that provided Medicare beneficiaries with insurance coverage for the 20 percent coinsurance cost not reimbursed by Medicare. In operating the complementary insurance program, BCWP used a totally integrated claims processing system under which claimant data on the Medicare claim forms was transferred by magnetic tape to BCWP's complementary program for payment.

Sharing of claimant data is authorized as long as the costs of activities that benefit Medicare and the complementary insurance program are shared equitably by both programs. Section 1600-1601, Part 1 of the Medicare Intermediary Manual as revised May 1986 by HCFA Transmittal No. 111, provides cost accounting guidelines for identifying and recording the costs

of transferring Medicare claimant data to the intermediary's own complementary insurance program.

The HCFA transmittal eliminated the standard charge to complementary insurers for the routine transfer of Medicare information and instead required full cost allocation for any routine transfer of Medicare information to complementary insurers. The revised Medicare guidelines specifically state that when using a totally integrated system, such as the system used by BCWP, charges to the complementary insurer will be determined by cost allocation. The revised guidelines further stipulate that:

- The term allocation means to distribute all costs to Medicare and the complementary insurance program in such proportion as to reflect the benefits received by each program.
- When both programs derive mutual benefits from an activity, full cost sharing is required.
- A cost center will be allocated if its activities benefit the complementary claims process. An activity benefits complementary insurance if that activity would have been necessary to fulfill the terms of the complementary contract or its normal claims processing requirements.

Our review showed that, contrary to the revised Medicare guidelines of May 1986, BCWP did not implement a cost allocation system to compute complementary credits, but continued to charge its complementary insurance program a standard rate of \$0.25 for each Medicare claim transferred to the complementary program during FYs 1987 through 1989.

We recomputed the complementary credits using the revised Medicare guidelines. In doing so, we developed cost allocation percentages, identified costs centers that benefitted both Medicare and the complementary insurance program, and applied these percentages to the total costs of the Medicare cost centers that we identified. We used the total costs of these centers since BCWP was not in compliance with the revised Medicare guidelines and had not developed an allocation method to identify specific costs in the cost centers that did not benefit the complementary insurance program.

## Cost Allocation Percentages

We based our cost allocation percentages on a claims processed ratio that was used by a Medicare carrier in Region III.<sup>1</sup> We identified the total number of Medicare claims transferred to the complementary insurance program during each fiscal year included in our audit and compared this number to the total number of Medicare claims processed and complementary claims transferred during the same fiscal year. Our allocation formula is illustrated below.

$$\frac{\text{Medicare Claims Transferred}}{\text{Total Medicare Claims} + \text{Claims Transferred}} = \text{Allocation Percentage}$$

Using this cost allocation methodology for FYs 1987, 1988 and 1989, we determined that BCWP's complementary insurance program should have been allocated 25.13 percent, 26.22 percent and 23.09 percent, respectively, of the costs of Medicare cost centers that benefitted the complementary program.

## Identification of Cost Centers

The next step in our recomputation was to identify Medicare cost centers that benefitted BCWP's complementary insurance program. The BCWP established 10 Medicare cost centers. We reviewed the functions and activities performed in these cost centers and determined that two of the centers also benefitted the complementary insurance program. The cost centers were:

### *Claims Operations*

This operation is responsible for all activities directly related to the processing of a Medicare claim form, including such functions as receipt, examination, coding, processing and/or rejection of claims; verification of computer generated claims processing; master file updating; reasonable charge review; medical review and utilization review; and claims quality control.

Because the Medicare claim form also serves as the form for 65 Special claims, we believe all of the functions in Claims Operation benefit the complementary claims process and the expenses should have been allocated. Expenses in this operation during the three year period amounted to over \$4.2 million.

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<sup>1</sup>6 We recently audited the Pennsylvania Blue Shield and determined that the claims processed methodology it used to allocate costs between Medicare and its complementary insurance program was fair and equitable.

## ***Electronic Media Claims (EMC)***

This operation is responsible for all automated procedures in support of the Medicare claim (as well as the 65 Special claim), including such functions as edit and validity checks, reasonable charge and duplicate claims checks, and prepayment utilization review. This operation also included costs of preparing the magnetic tapes to be transferred to the complementary program. Expenses in the EMC cost center during the three year period amounted to \$167,000.

To determine the credit allocation, we computed complementary claims ratios (claims transferred over total Medicare claims) for each year. We then applied the ratios against expenses reported for Claims Operation and EMC. Using this procedure, we believe that total complementary credits from BCWP amounted to \$1,223,544 (an average of \$.57 per claim versus \$.25 per claim reported). Therefore, the credits, as reported for BCWP, were understated by \$687,640 (audited \$1,223,544 less reported \$535,904).

### **Conclusions and Recommendations**

The BCWP was not in compliance with revised Medicare guidelines which required the costs of activities benefitting both Medicare and its complementary insurance program to be allocated to both programs. Instead of complying with the revised guidelines, BCWP continued to base its complementary credits to the Medicare program on a flat fee per claim transferred. As a result, BCWP understated the Medicare complementary credits by \$687,640 in FYs 1987 through 1989.

We therefore, recommend that BCWP:

1. Implement procedures to allocate costs between the Medicare and its complementary insurance program as required by the revised Medicare guidelines.
2. Reduce the FYs 1987, 1988, and 1989 FACPs by \$226,166, \$241,490, and \$219,984, respectively.

### **BCWP Response and Office of Audit Services Comments**

In its May 13, 1993 response, BCWP agreed that it was not in compliance with the revised Medicare guidelines which require a full cost allocation for any routine transfer of information after FY 1986, and that it had understated its Medicare complementary credits by \$171,348.

The BCWP stated that it has implemented procedures to allocate costs between Medicare and its complementary insurance program through the development of an allocation methodology. The BCWP stated that its methodology was different from the one that we used to develop the recommended financial adjustment, and that its method was more reflective of its environment.

We are pleased to see that BCWP has made an effort to comply with HCFA's revised Medicare guidelines. In its response, however, BCWP did not supply supporting documentation to demonstrate how the understated complementary credits of \$171,348 were computed. As a result, we were unable to evaluate the appropriateness of BCWP methodology or computations. If this information is provided to HCFA, we will provide assistance in evaluating BCWP's allocation methodology during the audit settlement process.



VERITUS INC.

GUS P. GEORGIADIS  
Corporate Vice President

May 13, 1993

Mr. Thomas J. Robertson  
Regional Inspector General  
for Audit Services  
Region II  
3535 Market Street  
Philadelphia, PA 19104



Dear Mr. Robertson:

We are responding to your letter of March 25, 1993, requesting comments on your Draft Report CIN A-03-90-02003, titled "Review of Medicare Administrative Costs Fiscal Years 1986-1989 Blue Cross of Western Pennsylvania."

Your letter asked for written comments by April 24, 1993. However, on April 19, 1993, Pat Marion of your staff granted us an extension of that due date to May 17, 1993.

When you read these comments, please keep in mind that there was no exit conference conducted at the end of the on-site review period, nor was there any post audit review of materials requested during the on-site review. The auditors who conducted this review had to curtail their stay citing lack of administrative funds. Although they said they would make another on-site visit, they never returned.

Some of the comments we are making now could have been provided at an exit conference and some of the proposed findings may have been resolved prior to your issuing this draft report. Therefore, we are requesting that you consider our comments at this time and if you concur, remove these findings from the final version of your report.

Please contact me if you have any questions.

Sincerely,

*Gus P. Georgiadis*  
Gus P. Georgiadis

GPG/pjf  
Enclosure



Review of Medicare Administrative Costs  
Fiscal Years 1986 - 1989

Blue Cross of Western Pennsylvania's  
Comments to Draft of Report

CIN: A-03-90-02003

Introduction

In the Conclusions and Recommendations portion on page 7 of the draft report, there are seven items to be addressed. Three of them are management recommendations and four are cost findings. These comments deal with each of these seven items in as much detail as possible depending on the amount of information that the auditor provided in the draft report.

Also, on page 10 you make a management finding and a cost finding related to BCWP's allocation of costs between Medicare and its complementary insurance program. We will discuss these recommendations separately in these comments.

OIG Recommendation Number 1.

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NOT PERTINENT  
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any systematic weakness in our internal controls and we therefore request that you consider removing it or modifying it in the final report.

OIG Recommendation Number 2

OIG's Position:

Provide HCFA with all appropriate information relative to the FAP agreement so that HCFA can determine if Medicare should be allocated rental cost of over \$1 million annually for the FAP.

BCWP's Comment:

BCWP will refer all information relative to the lease for space at FAP to the HCFA Regional Office. We will discuss the appropriateness of allocated space cost with HCFA.

OIG Recommendation Number 3

OIG's Position:

Obtain HCFA approval for all PI projects that are not mandated by HCFA.

BCWP's Comment:

Your report states on page 5 "Since PI projects are not included in the regular budget process, the projects and the budget for the projects must be approved by HCFA." This statement is at best confusing and at worst incorrect. HCFA does provide approval of and funding for all PI projects, mandated and not mandated, within the regular budget process.

We prepared all Budget Requests for the years reviewed in accordance with HCFA's instructions specifically Part A Part I of the Fiscal Administration Manual. Section 1213.9 of this manual is titled "Productivity Investments (Line 9)". Paragraph A of 1213.9 states "Include the cost of activities related to the development and implementation of the approved productivity investments and administrative enhancements." Section 1213.10 titled Other (Lines 10, 11, 12) states that productivity investment projects not contained in the budget guidelines (e.g., a contractor-initiated system enhancement) should be reported on line 10. Therefore, HCFA approved all PI projects for which they included funds since the NOBA constitutes authority to spend for the purpose specified in each line item.

This spending authority is conveyed by Article IV Paragraph B of the Medicare Agreement which states in pertinent part "... the Secretary shall issue a Notice of Budget Approval (NOBA) to the

Plan specifying the annual amount for the federal fiscal year..." In summary, we have always requested approval for PIs and will continue to do so. We request that you remove this recommendation from your final report.

OIG Recommendation Number 4

OIG's Position:

Reduce the FY 1988 FACP by \$579,367 and the FY 1989 FACP by \$580,022 for rental costs claimed but not incurred. Your report contains a reference to FARS 31.201-1 which defines the total cost of a contract as:

"...the sum of the allowable direct and indirect costs allocable to the contract, incurred or to be incurred, less any allocable credits..."

The report contains another reference to Section 31.201-5 of the FARs which defines credits as:

"The applicable portion of any income, rebate, allowance or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund."

Your position is that in computing the rental expense, BCWP did not offset the credit on the FACPs as required by FARs. Your report states that BCWP amortized the total cost of the lease over the lease term resulting in an overstatement of FY 1988 and 1989 rental costs allocated to Medicare.

BCWP's Comment:

BCWP believes the rental cost of \$579,367 and \$580,022 for FY 1988 and 1989 have been incurred and are properly included in the FACPs. The supporting facts and references are discussed in the following paragraphs.

The report states that credits have not been allocated as required by Section 31.201-5 of the FARs. In fact an equitable share of the rental credit has been allocated to the Medicare program. The allocation of the credit is reflected by the inclusion of the rent-free period in determining the total cost of the lease, the lease term and the resultant annual rental expense based on the lease term, including the rent-free period. The annual rental expense is lowered by the inclusion of the rent-free period in the calculation of the lease term.

BCWP allocated the rental expense following Section 31.205-36 of the FAR. FAR 31.205-36, Rental Costs, is applicable to the cost of renting or leasing real or personal property acquired under operating leases as defined in Financial Accounting Standards No. 13 (FAS-13). Per the criteria in FAS-13, the lease is an operating lease. Per FAR 31.205-36, the following costs are allowable; "Rental costs under operating leases, to the extent that the rates are reasonable...". Determining reasonableness is discussed in FAR 31.201-3. Briefly, per FAR 31.201-3, a cost is considered reasonable if it does not exceed that which would be incurred by a prudent person in the conduct of business. In effect, what is a reasonable cost depends on a variety of considerations including; whether it is the type of cost generally recognized as ordinary and necessary in the conduct of the contractor's business; generally accepted sound business practices; the contractor's responsibilities to the Government, other customers, owners of the business, employees and the public at large; and any significant deviation from the contractor's established practices.

Commitment to a 30-year lease is not an uncommon business practice. The rental rates and the rent-free period contained in the lease are in consideration of BCWP signing a 30-year lease. The "credit" resulting from the rent-free period applies to the entire term of the lease. It is not reasonable to assign a cost of zero to the initial year of the lease, as though the rent-free period stood on its own without any further obligation. The methodology used by BCWP to allocate rental charges to Medicare is consistent with the allocations to BCWP's other business units.

BCWP's position is further supported by FAR 31.201-2(a)(3), which sets forth as a factor in determining allowability "Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting practices and principles appropriate to the particular circumstances." Since the FAR and the CASB are silent regarding recognition of rental expense for operating leases when the annual rental expense varies over the term of the lease, generally accepted accounting principles prescribed by FAS-13 were followed by BCWP. FAS-13, paragraph 15, states "If rental payments are not made on a straight-line basis, rental expense nevertheless shall be recognized on a straight-line basis...". BCWP's accounting practices, as previously described, are in occurrence with FAS-13.

Based on the above information, BCWP believes that this recommendation should not be included in the final report.

OIG Recommendation Number 5

OIG's Position:

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NOT PERTINENT  
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FY 1986 PI Projects

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The report correctly identifies unspecified PI projects totaling \$347,178 as being claimed on BCWP's FY 1986 FACP. However, a review of the NOBA and records of administrative funds drawn establish that HCFA did not approve or pay the Plan more than the total claimed on the FACP. Therefore, this will have to be reconciled between BCWP and HCFA on the Closing Agreement for this audit report.

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OIG Recommendation Number 7

OIG's Position:

Reduce the FY 1989 by \$24,321 for overstated costs on the Purchased Services Agreement (PSA) with the Shared Services Center (SSC). Your report states on page 2 that "With exceptions to our adjustments for overstated expenses of \$24,321 for SSC, our review did not identify any material discrepancies with costs claimed under the PSA's." On page 6 of the report you stated that the SSC reported estimated rather than actual expenses which resulted in an overstatement of \$8,712. In addition, SSC also included an expense of \$15,609 that was misclassified and should have been charged to another SSC customer.

BCWP's Comment:

BCWP accepts this recommendation by the OIG.

OIG Recommendation of Complementary Credits

OIG's Position:

The OIG recommends that BCWP implement procedures to allocate costs between Medicare and its complementary insurance program and that BCWP reduce the FY 1987, 1988, and 1989 FACPs by \$226,166, \$241,490, and 219,984 respectively.

On pages 2 and 3 of the OIG report you stated that you reviewed the accuracy, reasonableness and allowability of Medicare complementary credits computed by BCWP for FY's 1987 through 1989. Page 7 of your report further states that BCWP reported complementary credits on a standard rate of \$.25 for every Medicare claim transferred to the complementary insurance program. You accurately state that this method was not in compliance with revised Medicare guidelines which required a full cost allocation for any routine transfer of information after FY 1986.

On pages 8 - 10 you recount how you recomputed the complementary credits using the revised Medicare guidelines basing your cost allocation percentages on a claims processed ratio that was used by a Medicare carrier, Pennsylvania Blue Shield (PBS).

BCWP's Comment:

Since we do not at this time have access to any workpapers you may have prepared in recomputing complementary credits we are relying on the content of the report itself. First, and most importantly, we must point out that using PBS claims processed methodology to allocate costs between Medicare carrier operations and its complementary insurance program may be fair and equitable when evaluating PBS' situation. However, it is neither fair or equitable to compare BCWP to PBS. There are vast differences between a Part B carrier who processes 50 million claims, half of which are paper claims and a Part A contractor who processes 5 million claims, of which 98% are filed electronically

The following explanation is intended to provide a better understanding of our environment and to provide the results of recasting our current allocation method to the years examined in this report.

Claims are transferred to the Complementary System through a fully automated system at Blue Cross of Western Pennsylvania. We have applied our current allocation methodology to fiscal years 1987 through 1989 expenses to compare the results to the standard rate of \$.25 used in those fiscal years.

We identified the total number of Medicare claims transferred to the complementary insurance program during each fiscal year and compared it to the total number of Medicare claims processed. Our allocation formula is illustrated below.

Medicare Claims Transferred  
----- x 50% = Allocation Percent  
Total Medicare Claims

This formula recognizes the fact that each claim processed uses the same amount of Medicare resource whether it is a Medicare only claim or a Medicare/Complementary claim. Also, the processing of

the Complementary claim is not part of the Medicare claims process. It is done by the Private Blue Cross system after the Medicare data is passed to them. We know that Medicare and Private Blue Cross both benefit from the processes applied to the Medicare claim but we found no definitive way to measure the comparative benefit so we assigned equal weight.

We believe our formula is more reflective of our environment. The formula presented in the audit report seems to overweigh the Medicare/Complimentary claim. These claims do not require double the effort or resource by the Medicare processing components.

Using this formula for Fiscal years 1987, 1988, and 1989, we determined that our complementary insurance program should have been allocated 16.1 percent, 16.6 percent, and 14.6 percent, respectively, of the costs of the appropriate Claims, Systems, and Medical Review Cost Centers. These are the Medicare Cost Centers that we believe benefitted the complementary program.

Using this procedure we believe that the total complementary credits amounted to \$1,124,283 (an average of \$.295 cents per claim versus \$.25 per claim reported). Therefore, the credits, as reported by BCWP, are understated by \$171,348 (\$1,124,283 less \$952,935 reported).

Therefore, we request that the section on complementary credits be amended to recognize that BCWP has implemented procedures to allocate costs between Medicare and its complementary insurance program as required by Medicare guidelines and that the recommended reductions to the FY 1987, 1988, and 1989 FACPs be changed to read, \$32,388, \$53,250, and \$85,710 respectively.