



DEPARTMENT OF HEALTH AND HUMAN SERVICES
OFFICE OF AUDIT SERVICES
233 NORTH MICHIGAN AVENUE
CHICAGO, ILLINOIS 60601
June 12, 2003

REGION V
OFFICE OF
INSPECTOR GENERAL

Report Number: A-05-02-00047

Ms. Sandy Coston, President
United Government Services, LLC
401 West Michigan Street
Milwaukee, WI 53203-2804

Dear Ms. Coston:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), Office of Audit Services' (OAS) final report entitled, "Review of Medicare Part A Administrative Costs Claimed for the Period October 1, 1998 through September 30, 2001." A copy of this report will be forwarded to the action official noted below for review and any action deemed necessary.

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

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. 552, as amended by Public Law 104-231, OAS reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise (see 45 CFR part 5).

To facilitate identification, please refer to report number A-05-02-00047 in all correspondence relating to this report.

Sincerely,

A handwritten signature in cursive script that reads "Paul Swanson".

Paul Swanson
Regional Inspector General
for Audit Services

Enclosures – as stated

Direct Reply to HHS Action Official:

Mr. David DuPre
Acting Regional Administrator
Centers for Medicare and Medicaid Services
Department of Health and Human Services
233 North Michigan Avenue, Suite 600
Chicago, Illinois 60601-5519

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF MEDICARE PART A
ADMINISTRATIVE COSTS CLAIMED
FOR THE PERIOD OCTOBER 1, 1998
THROUGH SEPTEMBER 30, 2001**

**UNITED GOVERNMENT SERVICES, LLC
MILWAUKEE, WISCONSIN**



June 2003
A-05-02-00047

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
at <http://oig.hhs.gov>

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. 552, as amended by Public Law 104-231, Office of Inspector General, Office of Audit Services, reports are made available to members of the public to the extent information contained therein is not subject to exemptions in the Act. (See 45 CFR Part 5.)

OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed as well as other conclusions and recommendations in this report represent the findings and opinions of the HHS/OIG/OAS. Final determination on these matters will be made by authorized officials of the HHS divisions.



EXECUTIVE SUMMARY

OBJECTIVE

The objectives of our audit were to determine whether United Government Services (UGS) had (i) established an effective system of internal control to account for and report Medicare administrative costs claimed and (ii) properly claimed allowable administrative cost for fiscal years (FYs) 1999 through 2001, in accordance with Part 31 of the Federal Acquisition Regulation (FAR), as interpreted and modified by the Medicare contract.

FINDINGS

The UGS established an effective system of internal control to account for and report Medicare administrative costs claimed and generally claimed allowable administrative costs on its Final Administrative Cost Proposals (FACPs) for FYs 1999 through 2001. With the exception of \$260,831 in excessive executive compensation increases, unallocable guarantee fees and overcharged corporate overhead, the UGS total claims of approximately \$198.5 million were generally acceptable. We are recommending costs for acceptance in the amount of \$196,734,807. We exclude pension costs of \$1,370,941 and Year 2000 (Y2K) costs of \$121,186, which will be reported in separate audits.

The items recommended for adjustment are summarized below and reported in greater detail in the FINDINGS AND RECOMMENDATIONS section of this report.

Executive Compensation Increases. The UGS overstated Medicare costs by \$94,241 for executive compensation increases that exceeded the average increases for comparable positions, as measured by the Employment Cost Index (ECI).

Guarantee Fees. The UGS paid a monthly fee to its parent organization to indemnify or guarantee payment to BlueCross BlueShield Association (BCBSA) against potential claims resulting from UGS obligations. This indemnification payment, required by BCBSA, was not allowable under the contract terms. The fees also provided no direct benefit to Medicare and are, therefore, not allocable to the Medicare program. The parent organization, Blue Cross & Blue Shield United of Wisconsin (BCBCUW), upon advice from the State Insurance Commissioner, required UGS to pay the fee, which totaled \$47,247 (Medicare share) for the audit period.

Corporate Overhead Adjustment. A UGS internal review of its cost allocation process identified corporate overhead of \$501,403 charged incorrectly to Medicare. Of this amount, \$119,343 applies to the audit period. The remaining \$382,060 (for FYs 1995 through 1998) was recovered as part of the final settlement reached with CMS according to Closing Agreement 14, dated February 18, 2003.

RECOMMENDATIONS

We recommend that UGS make a financial adjustment for:

- Executive compensation of \$94,241 that exceeded the increases allowed by the Employment Cost Index.
- Guarantee fees of \$47,247 charged to Medicare with no apparent benefit to the contract.
- Corporate overhead of \$119,343 that was not allocable to Medicare during the audit period.

UGS's COMMENTS

The UGS officials do not believe the ECI should be used as the sole measure for the allowability of employee compensation because it does not consider the significant increases in size, complexity, and responsibility UGS experienced during the audit period. With respect to the guarantee fees, UGS stated the Medicare contract benefited from the control environment established when UGS became a separate legal entity. The BCBSA requires the member plans be licensed to provide administrative services to the Medicare program, therefore, the fee was incurred for the general conduct of UGS's business and should be allowable. The UGS stated it would refund the corporate overhead during the audit settlement, unless instructed otherwise by CMS. The UGS written response is presented in its entirety in the report APPENDIX.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

The Department of Labor's ECI was used because it is a widely recognized, unbiased measure of industry-wide compensation practices and eliminates the effects of employment shifts among occupations. Regarding the guarantee fee to BCBSUW, we believe this is an unnecessary expense since there is little or no financial risk for BCBSUW or BCBSA when UGS is guaranteed reimbursement for reasonable and allowable costs under the Medicare contract.

TABLE OF CONTENTS

	Page
INTRODUCTION	1
BACKGROUND	1
OBJECTIVE, SCOPE AND METHODOLOGY	
Objective	1
Scope	2
Methodology	2
FINDINGS AND RECOMMENDATIONS	
EXECUTIVE COMPENSATION INCREASES	3
GUARANTEE FEES	
Indemnification	5
Government Non-Risk Business	5
Captive Insurer Situation	5
CORPORATE OVERHEAD ADJUSTMENT	7
APPENDIX	
UGS's Written Comments to Draft Report	
EXHIBIT A - Final Administrative Cost Proposal and Auditor Recommendations For the Fiscal Year Ending September 30, 1999	
EXHIBIT B - Final Administrative Cost Proposal and Auditor Recommendations For the Fiscal Year Ending September 30, 2000	
EXHIBIT C - Final Administrative Cost Proposal and Auditor Recommendations For the Fiscal Year Ending September 30, 2001	

INTRODUCTION

BACKGROUND

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled (Medicare) program. Hospital Insurance (Medicare Part A) provides protection against the cost of hospital and related care. The CMS, a division of the U.S. Department of Health and Human Services, administers the Medicare program. Under an agreement with CMS, BCBSA participates as a Medicare intermediary to assist in program administration.

Under a subcontract with BCBSA, UGS receives, reviews, audits, and pays Medicare Part A claims. On January 1, 1999, UGS converted from a division of Blue Cross & Blue Shield United of Wisconsin (BCBSUW) to a wholly owned subsidiary of BCBSUW. The UGS, part of a family of companies owned by Cobalt Corporation, is headquartered in Milwaukee, Wisconsin.

For over 30 years, UGS has had an agreement with CMS to process Medicare Part A claims and provide other administrative services. Through its continued growth, UGS has become CMS' largest Medicare Part A intermediary and now processes claims from:

- hospitals, skilled nursing facilities, outpatient physical therapy and comprehensive outpatient rehabilitation facilities, end stage renal disease facilities, rural health clinics and critical access hospitals in Wisconsin, Michigan, Virginia, West Virginia, California, Nevada, Hawaii, Guam, American Samoa and Northern Mariana Islands;
- home health agencies and hospices in Wisconsin, Michigan, New York, New Jersey, Minnesota, Puerto Rico, Virgin Islands, Alaska, California, Nevada, Oregon, Washington, Idaho, Arizona, American Samoa, Guam and Northern Marian Islands; and
- Federally qualified health centers in all 50 states.

Subject to limitations specified in the agreements, UGS is entitled to reimbursement for reasonable administrative costs incurred. For the period October 1, 1998 through September 30, 2001, UGS claimed \$198,487,765 in Medicare administrative costs.

OBJECTIVE, SCOPE AND METHODOLOGY

Objective. The objectives of our audit were to determine whether UGS had (i) established an effective system of internal control to account for and report Medicare administrative costs claimed and (ii) properly claimed allowable administrative costs on its FACPs for FYs 1999 through 2001, in accordance with Part 31 of the FAR, as interpreted and modified by the Medicare contract.

Scope. The audit covered \$196,995,638 of Medicare Part A administrative costs claimed by UGS on its FACPs for FYs 1999, 2000 and 2001. We did not include pension costs of \$1,370,941 and Year 2000 (Y2K) costs of \$121,186, which are the subjects of separate audits. A separate future audit will deal with the specialized nature and complexity of pension issues,

while the audit of Y2K costs was recently covered by a separate report (Audit Report Number A-05-02-00054).

In performing the audit, we placed reliance on the work performed by UGS internal audit staff and independent public accounting firms, as explained below. Due to the limited nature of our review, we do not express an opinion on UGS' system of internal controls taken as a whole.

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 accordance with applicable laws and regulations.

Methodology. To accomplish our objectives, we reviewed the Medicare contract and amendments, Part 31 of the FAR, and other criteria as necessary. We verified the mathematical accuracy of the FACPs and reconciled the FY 2001 FACP to UGS accounting records on a selective basis.

Regarding internal controls, we reviewed:

- UGS organization charts, charts of accounts, lists of cost centers and allocation bases, manager accounting reports, and accounting policies and procedures;
- reports and working papers for the two prior audits of Medicare administrative costs and for the financial statement audits of UGS covering CYs 1999 through 2001;
- internal control certification documents prepared by UGS for FYs 1999, 2000 and 2001 and the independent auditor's review of the certification documentation covering FYs 1999 and 2000;
- risk assessments for FYs 2000 and 2001 prepared by UGS;
- reports on the operating effectiveness of UGS internal controls during July 1999 to March 2000 and October 2000 to March 2001 prepared by a public accounting firm; and
- five selected UGS internal audits.

Regarding Medicare administrative costs, we focused our substantive audit tests on the most recent year and expanded our audit tests to the previous two years as considered necessary. We concentrated on the largest cost categories of salaries, fringe benefits, subcontracts, and outside consultants. In addition, we tested depreciation costs, board member compensation, complementary credits, and certain general and administrative costs. We reviewed executive compensation allocated to Medicare for both the reasonableness of annual increases and compensation in excess of salary caps. We verified costs claimed to supporting documentation and interviewed UGS officials.

Our fieldwork was conducted at the UGS corporate office in Milwaukee, Wisconsin, from March to August 2002. We also reviewed the public accounting firm's working papers at its office in Milwaukee.

Our audit was conducted in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

EXECUTIVE COMPENSATION INCREASES

The UGS overclaimed Medicare costs by \$94,241 for executive compensation increases that exceeded the average increases for comparable positions, as measured by the Employment Cost Index (ECI). We used the index for private industry executive, administrative and managerial occupation compensation because we considered it to be the most equitable and relevant measure. For this executive occupation group, the average ECI salary increases for calendar years (CYs) 1999, 2000 and 2001 were 4.00 percent, 4.30 percent and 3.60 percent, respectively.

Article XIII B. of the Medicare contract provides for reimbursement of reasonable and allowable costs incurred in accordance with Part 31 of the FAR. In determining reasonableness, FAR 31.201-3 states that:

...(a) A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business....

With respect to compensation for personal services, FAR 31.205-6 states that:

...(b) ...In addition to the provisions of 31.201-3, in testing the reasonableness of individual elements for particular employees or job classes of employees, consideration should be given to factors determined to be relevant to the contracting officer.

(1) Among others, factors which may be relevant include general conformity with the compensation practices of other firms of the same size, ... firms in the same industry, ... firms in the same geographic area, ... firms engaged in predominantly non-Government work, and the cost of comparable services obtainable from outside sources....

To measure these factors, we used the U.S. Department of Labor (DOL) quarterly Employment Cost Indexes. The ECI represents dozens of indices that DOL calculates for various occupational and industry groups to measure the rate of change in employee compensation. It is a fixed weight index at the occupational level and eliminates the effects of employment shifts among occupations. The ECI is distinguished from other surveys in that it covers all establishments and occupations in both the private non-farm and public sectors.

Considering these ECI rates of increase, we analyzed salary increases for two executives with significant compensation charged to Medicare. For each calendar year, we compared the compensation increases for the one UGS and one BCBSUW (UGS' parent company) executive to the compensation increases derived using the ECIs, converted the differences to a FY basis,

and calculated the amount allocated to Medicare. Total salaries charged to Medicare in excess of the ECI adjusted salaries was \$94,241, as follows:

FY 1999	\$ 21,492
FY 2000	22,428
FY 2001	<u>50,321</u>
Total	<u>\$ 94,241</u>

The compensation increases exceeded the ECI because UGS and BCBSUW did not consider the ECI to be an appropriate, single criterion for establishing compensation increases. UGS did not disagree with our calculations, but instead, disagreed with the ECI as criteria for measuring reasonable increases.

Recommendation

We recommend that UGS make a financial adjustment of \$94,241 for excessive executive compensation charged to Medicare.

UGS's Comments

The UGS officials believe their executive compensation package is reasonable for the insurance industry. They stated the ECI does not take into consideration the many variables experienced by UGS during the audit period, namely, significant increases in size, complexity, and responsibility. In addition, UGS feels the "executive, administrative, and managerial" ECI category is too broad to be an accurate guide for the Medicare contracting environment as it combines all executive, administrative and managerial positions, regardless of the size and complexity of the company or industry. They also stated that, a market survey performed for the prior audit, showed the UGS's executive compensation was below the average base market salary rates in each fiscal year and pointed out that CMS agreed with the UGS position when settling the prior audit period. The full text of the UGS written comments is located in the report APPENDIX.

Office of Inspector General's Response

The Department of Labor's ECI was utilized for the express purpose of judging the reasonableness of salary increases. We used the index for executive compensation because it is a widely recognized, unbiased measure of industry-wide compensation practices. It is a fixed weight index at the occupational level and eliminates the effects of employment shifts among occupations.

GUARANTEE FEES

The UGS paid monthly fees to its parent organization, BCBSUW, to indemnify (guarantee payment to) BCBSA against potential claims resulting from UGS obligations. The BCBSA required indemnification from BCBSUW as part of license membership rules, which include use of their trademark.

As an insurance company, BCBSUW is required to disclose to the State Insurance Commissioner certain transactions with affiliates, including guarantees. The BCBSUW filed the required documents and a proposed agreement on behalf of UGS. The BCBSUW described UGS as a "small, non-risk bearing government controlled affiliate" that was established to "wall off" the business subject to CMS regulation. Despite the apparent low financial risk of UGS as a government contractor, the Insurance Commissioner believed BCBSUW should be compensated for its guarantee of UGS obligations. BCBSUW required UGS to pay the guarantee fees which were charged, in part, to the Medicare contract.

Indemnification. With regard to indemnifying obligations, FAR 31.205-19 (f) states the government is obliged to indemnify a contractor:

...only to the extent authorized by law, as expressly provided for in the contract, except as provided in paragraph (a)(3)....

The FAR paragraph (a)(3) states that actual losses are unallowable unless expressly provided for in the contract, except for nominal deductible amounts and minor losses not covered by insurance.

Article XI of the Medicare contract limits government indemnification to administrative or judicial proceedings by providers or beneficiaries that arise from claims processing activities under the contract. The contract does not provide for the type of indemnification represented by the guarantee fee.

Government Non-Risk Business. In addition to not being provided for in the contract, the guarantee fee is not a necessary expense and does not benefit the Medicare contract. Although the BCBSA required BCBSUW to guarantee UGS obligations, we believe there is little financial risk when UGS' primary business is covered by a cost reimbursement contract. According to Article XIII of the Medicare contract, CMS will reimburse UGS for reasonable and allowable costs up to the authorized budget amount.

Captive Insurer Situation. Since the parties to this agreement are related, the arrangement is similar to a captive insurer situation and FAR 31.205-19 (c) pertaining to captive insurance applies:

... Insurance provided by captive insurers (insurers owned by or under the control of the contractor) is considered self-insurance, and charges for it must comply with the self-insurance provisions of 48 CFR 9904.416....

Section 416.50(a)(2)(i) of 48 CFR 9904.416 states that self-insurance costs shall not exceed the cost of comparable purchased insurance and should be evaluated regularly to ensure the amount charged reflects the contractor's actual loss experience. If such insurance cannot be purchased, the self-insurance charge shall be based on the contractor's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles.

The amount of the guarantee fee was calculated at .05 percent of the prior year’s UGS direct and indirect administrative costs, which was then allocated to UGS lines of business. During FYs 2000 and 2001, Medicare was charged between 88 and 94 percent of the guarantee fee. We were unable to determine how the basis rate and fee amount were derived. We were not provided with any evidence that the fees charged were based on competitive pricing, actuarial principles or loss evaluations.

We concluded the guarantee fees were unallowable because: 1) indemnification costs are allowed only if required by law, as expressly provided in the contract, 2) the fees were not necessary and did not provide a direct benefit to Medicare contract performance, and 3) the guarantee fee valuation was not based on competitive pricing or a review of actual loss experience.

The UGS began paying the guarantee fees effective January 2000. The totals paid through the end of our audit period, September 2001, were:

	<u>Paid</u>	<u>Medicare share</u>
FY 2000	\$19,273	\$17,159
FY 2001	<u>32,544</u>	<u>30,088</u>
Total	<u>\$51,817</u>	<u>\$47,247</u>

Recommendation

We recommend that UGS make a financial adjustment for guarantee fees of \$47,247 charged to Medicare.

UGS’s Comments

The UGS responded that, the BCBSA holds the master contract with CMS and imposed certain requirements regarding the licensure of UGS, including the guarantee agreement. The UGS believes the organizational changes in 1999 (separate UGS management, compliance, and internal audit staff and Board of Directors) have established a control environment that directly benefits the Medicare contract. In addition, UGS stated that member plans must be licensed through BCBSA in order to carry out their duties as Medicare intermediaries. They believe the guarantee fee is allowable as it was incurred for the general conduct of UGS’ business (FAR 31.205-19 (a)(2)). Regarding the fee valuation, UGS officials stated competitive pricing was not possible since BCBSUW was the only entity that could provide the guarantee. They believe the fee for UGS was reasonable in comparison to the fee required for another affiliate, an insurance business with more financial risk. Although the fee should be .05 percent, the draft report incorrectly showed it as 5 percent.

Office of Inspector General’s Response

We understand that BCBSA holds the master Medicare contract with CMS and UGS is a member plan providing the administrative services for Medicare Part A claims processing.

However, as previously cited, the Medicare contract limits the government’s indemnification obligations to suits by providers or beneficiaries. While BCBSA requires the member plans to be licensed and pay a guarantee fee, we fail to see how the payment of \$30,000 per year is a necessary Medicare expense since the financial obligations of UGS are already guaranteed reimbursement under the contract. There is little or no financial risk involved for BCBSUW or BCBSA. We believe that, since FY 2000, BCBSUW has provided no funds for any claims against BCBSA on UGS’s behalf. As a result, we believe this is an unnecessary expense and continue to recommend a financial adjustment for the guarantee fees of \$47,247. We have corrected the fee percentage in this report.

CORPORATE OVERHEAD ADJUSTMENT

A UGS internal review of its cost allocation process identified Medicare overcharges of \$501,403 for corporate overhead for FYs 1995 to 2000. Overcharges of \$119,343 pertain to our audit period. The remaining \$382,060 (for FYs 1995 through 1998) was recovered as part of the final settlement with CMS in Closing Agreement 14, dated February 18, 2003.

The UGS attributes the overcharges to an inadvertent allocation to subsidiaries based on the use of a particular brand of general ledger accounting system. Since some subsidiaries were not yet using this accounting system, they did not receive their appropriate share of corporate overhead. On the other hand, UGS used this brand of general ledger accounting system and received a larger than appropriate share.

The corporate overhead overcharged to UGS Medicare by Federal FY amounted to:

FY 1999	\$ 96,929
FY 2000 (October-December 1999)	<u>22,414</u>
Total	<u>\$119,343</u>

The UGS acknowledged that corporate overhead (pertaining to United Wisconsin Services, Inc., a holding company, and BCBSUW, an insurance company and parent of UGS) should be allocated fairly and equitably to all benefiting lines of business.

Recommendation

We recommend that UGS make a financial adjustment for overstated corporate overhead of \$119,343 applicable to the audit period.

UGS’s Comments

The UGS agreed to refund the \$119,343 as part of the final settlement with CMS for the audit period, unless otherwise instructed by CMS.

APPENDIX

UGS's Written Comments to the Draft Report



SANDY COSTON, CPA
CHAIRMAN AND PRESIDENT

February 28, 2003

Mr. Paul Swanson
Regional Inspector General for Audit Services
DHHS/OIG/OAS
233 North Michigan Avenue
Chicago, IL 60601

RE: Audit Report Number A-05-02-00047

Dear Mr. Swanson:

Thank you for the opportunity to respond to the draft report "Audit of Medicare Part A Administrative Costs Claimed for the Period October 1, 1998 Through September 30, 2001." Enclosed please find United Government Services, LLC's comments and responses to the draft audit report.

If you have any questions on the attached information, please feel free to contact me at (414) 226-5588 or Cheryl Leissring at (414) 226-5884.

Sincerely,

Enclosure

Copy: Cyndi Owens, OIG
Cheryl Leissring, UGS
Todd Reiger, UGS
Kendall Greenwood, UGS
Randy Oleszak, UGS
Dave Strzyzewski, UGS

United Government Services, LLC
Response to the Audit of Medicare Part A Administrative Costs
Claimed for the Period October 1, 1998 through September 30, 2001
Draft Report

Below are UGS' proposed corrections and our responses to the Medicare Administrative Cost Audit Draft Report.

Executive Compensation Increases

United Government Services, LLC (UGS) disagrees with the finding in the report that states that the FACPs were overstated by \$94,921 for executive compensation increases that exceeded the average increases for comparable positions as measured by the Department of Labor's Bureau of Labor Statistics Employment Costs Index (ECI).

UGS believes that its executive compensation package is reasonable in the insurance industry and disagrees with the use of the ECI to measure the reasonableness of employment compensation. Using overall salary increase trend information to determine the reasonableness of a compensation package can be deceiving and does not take into consideration the many variables experienced by UGS during the audit period.

1. As a Medicare contractor, UGS increased its Medicare claims volume approximately 99% during the audit period from 13.6 million claims in fiscal year 1999 to 27.0 million claims in fiscal year 2001. The number of employees within UGS Medicare increased from approximately 300 to 1,100 during this time period and the number of UGS Medicare offices increased from 3 offices in two states to 13 offices in eight states. The increases in claim volumes, staffing levels and office locations was the direct result of additional Medicare areas of coverage, including contracts to process Medicare Part A claims for Michigan, Virginia, West Virginia, California, Nevada, Hawaii, the Northern Mariana Islands, Guam, American Samoa and home health and hospice claims for California, Nevada, Hawaii, Alaska, Arizona, Oregon, Idaho, Washington, the Northern Mariana Islands, Guam, and American Samoa. The ECI calculation and the audit finding do not consider the increase in the size, complexity, and responsibility of the Medicare contract at UGS during the audit period.
2. The ECI category of "Executive, administrative, and managerial" was used to determine the annual percentage increase for executive level positions. UGS feels this category is too broad to be an accurate guide in the Medicare contracting environment. The size and complexity of the health care industry in general, and Medicare in particular, require an organization of sufficient size, financial resources and executive talent to be effective in handling Medicare business. The ECI category, which includes all civilian (non-federal) non-farm positions, does not factor these items into its calculations. The ECI also aggregates executive, administrative and managerial positions together, each of which has a different increase rate. In addition,

APPENDIX
Page 3 Of 5

United Government Services, LLC
Response to the Audit of Medicare Part A Administrative Costs
Claimed for the Period October 1, 1998 through September 30, 2001
Draft Report

the ECI looks at any and all executive, administrative and managerial positions, regardless of the size and complexity of the company or its industry.

3. The audit did not attempt to determine the reasonableness of the base salary compensation relative to market values. If executives had been grossly overpaid in the base year, but then received increases in-line with the ECI in subsequent years, there would be no audit finding. Conversely, if executives were paid below the market rate in the base year and an attempt was made during the audit period to maintain their competitive position, but still within market salary guidelines, the audit would state a finding. To address this finding in our previous administrative cost audit, UGS had obtained market survey data from our compensation consultants, Hewitt Associates, which clearly indicated that the base salary for the UGS executive cited in the finding was below the average base market salary rates during each of the previous fiscal years included in the prior audit period.

Due to the cost involved in obtaining the market survey data (\$5,000 – \$7,000) and the fact that the Centers for Medicare and Medicare Services agreed with our previous position relative to the use of the ECI, UGS did not obtain similar data for this report, as we did not feel it would be fiscally prudent given the current funding situation. However, we would be willing to obtain the data if it is necessary to resolve this audit issue.

4. As a Medicare contractor, UGS is governed by the cost principles in Part 31 of the Federal Acquisition Regulation (FAR). Specifically, FAR 31.205-6 (a) provides the following measures for cost allowability of employee compensation:
 - Compensation for personal services must be for work performed in the current year and may not represent a retroactive adjustment.
 - The compensation in total must be reasonable for the work performed.
 - The compensation must be based upon and conform to the terms and conditions of the contractor's established compensation plan or practice followed consistently.
 - Major revisions in existing compensation plans will offer no presumption of cost allowability.
 - Cost otherwise unallowable in other subsections of the FAR shall not be allowable under this subsection.

We do not believe that the above language or language elsewhere in the FAR provides the authority to exclusively employ the ECI index to determine the reasonableness of executive compensation. We agree that FAR 31.205-6 (b) provides the authority to test

United Government Services, LLC
Response to the Audit of Medicare Part A Administrative Costs
Claimed for the Period October 1, 1998 through September 30, 2001
Draft Report

the reasonableness of any element of compensation, or total compensation, however, we do not believe that the ECI should be used exclusively as the sole measure for the allowability of employee compensation.

In addition, UGS is subject to the Budget and Performance Requirements (BPRs) issued by the Centers for Medicare and Medicaid Services (CMS). The BPRs include provisions regarding executive compensation. There is a cap (i.e. ceiling) on the amount of executive compensation that is allowed under government contract costs. Both of the executives identified in this audit finding were under that cap for each of the fiscal years included in the audit.

Guarantee Fees

The BlueCross BlueShield Association (BCBSA) holds the master contract with CMS for the Medicare Part A processing. The BCBSA in turn subcontracts the Medicare Part A processing to member plans. Prior to 1999, United Government Services was a division of Blue Cross & Blue Shield United of Wisconsin (BCBSUW) and administered the Medicare Part A contract on behalf of BCBSUW. Since 1999, BCBSUW and UGS have taken great strides to strengthen the control environment and mitigate any potential or perceived conflicts of interest between BCBSUW's commercial business and the administration of the Medicare contract. These efforts meant establishing UGS as a separate legal entity, with an external majority Board of Directors. In doing this, there were also certain requirements imposed by the BCBSA regarding the licensure of UGS, including the guarantee agreement discussed in this finding.

The draft audit report states that there is no direct benefit to Medicare contract performance. UGS disagrees with this statement. We believe that the control environment established has a direct benefit to the Medicare contract. The structure of the organization allows UGS to have dedicated management staff, dedicated compliance and internal audit staff, and an independent Board of Directors who are all focused on meeting the Medicare contractual obligations and mitigating any potential conflicts of interest with BCBSUW's commercial business.

Furthermore, under the BCBSA licensure requirements, the Medicare program benefited as member BCBSA plans must be licensed through the BCBSA in order to provide administrative services to the Medicare program. As a result of these licensure requirements, a "cause and effect" relationship is established. In order to perform administrative services for Medicare, member plans of the BCBSA must maintain an appropriate BCBSA license. Without a license, UGS is unable to carry out its duties as a Medicare Intermediary. Payment of the guarantee fee, therefore, is an allowable expenditure as it is "maintained in connection with the general conduct" (FAR 31.205-19(a)(2)) of UGS' business.

United Government Services, LLC
Response to the Audit of Medicare Part A Administrative Costs
Claimed for the Period October 1, 1998 through September 30, 2001
Draft Report

With respect to the statement that the guarantee fee valuation was not based on competitive pricing or a review of actual loss experience, this was not possible under the requirements of the licensure agreement. In accordance with this agreement, BCBSUW was the only entity that could have provided this guarantee. No other entity could have provided a guarantee of UGS' financial obligations even if they wanted to. Therefore, competitive pricing was not an option under this transaction.

In determining the overall reasonableness of the guarantee fee, however, UGS can demonstrate this through the approval that was provided by Office of the Commissioner of Insurance (OCI). The OCI, an outside government agency, required and approved the fee for BCBSUW's commitment in addition to a similar fee that had to be paid by another controlled affiliate of BCBSUW, Compcare Health Services Insurance Corporation (Compcare). In looking at the differences between UGS and Compcare, the fee paid by UGS was established at a smaller amount by virtue of the lower level of financial risk that a non-insurance affiliate presents versus an insured affiliate. Based on the OCI's approval of the rate structure, UGS has demonstrated the reasonableness of the guarantee fee it pays to BCBSUW. (Note: the fee paid to BCBSUW is incorrectly reported in the report as 5%. The correct fee is .05% or 5 basis points)

UGS disagrees with this audit finding for the reasons described above and respectfully requests that this finding be removed.

Corporate Overhead Adjustment

As identified in the draft report, UGS identified and reported corporate overhead allocation overages from previous fiscal years. Since the time of this audit, CMS has provided UGS with guidance on how to return these funds and for fiscal years 1995 – 1998 the adjustments were included in the closing agreement for those years. UGS submitted a check to CMS on December 18, 2002 for the settlement.

UGS will work with CMS to return the remaining funds related to fiscal years 1999 and 2000 during the closing agreement and settlement of this audit report, unless otherwise instructed by CMS. In addition, since the time of this audit, UGS has identified some additional unallowable costs that were submitted during this time period. We will also work with CMS to include those items in the closing and settlement of this audit report unless otherwise instructed.

EXHIBIT A

UNITED GOVERNMENT SERVICES, LLC
 FINAL ADMINISTRATIVE COST PROPOSAL
 AND THE AUDITORS RECOMMENDATIONS
 FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 1999

<u>Medicare Activity Description</u>	<u>Administrative Costs</u>
Bills/Claims Payment	\$11,209,483
Appeals/Review	1,979,716
Inquiries	3,084,236
Program Management – Provider Education and Training	976,600
Reimbursement	2,344,850
Productivity Investments	1,750,908
Complimentary Credits	(1,243,895)
Medical Review	5,475,873
Medicare Secondary Payer	3,146,679
Benefits Integrity	1,242,340
Medicare Integrity Program – Provider Education and Training	561,728
Provider Audit	<u>10,393,474</u>
 Total Costs Claimed on FACP	 \$40,921,992
 <u>Costs Excluded From Audit Scope</u>	
Pension Costs	\$ 209,218
Year 2000 (Y2K) Costs	<u>121,186</u>
 Total Costs Excluded From Audit Scope	 \$ 330,404
 <u>Recommended Adjustments</u>	
Executive Compensation	\$ 21,492
Corporate Overhead Adjustment	<u>96,929</u>
 Total Recommended Adjustments	 \$ 118,421
 Total Recommended for Acceptance	 <u>\$40,473,167</u>

NOTE: Explanation for each adjustment is provided in the FINDINGS AND RECOMMENDATIONS section of this report.

EXHIBIT B

UNITED GOVERNMENT SERVICES, LLC
 FINAL ADMINISTRATIVE COST PROPOSAL
 AND THE AUDITORS RECOMMENDATIONS
 FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 2000

<u>Medicare Activity Description</u>	<u>Administrative Costs</u>
Bills/Claims Payment	\$16,235,320
Appeals/Review	2,628,235
Inquiries	4,321,682
Program Management – Provider Education and Training	1,119,943
Reimbursement	3,671,096
Productivity Investments	502,297
Complimentary Credits	(1,828,230)
Medical Review	8,997,026
Medicare Secondary Payer	4,428,281
Benefits Integrity	1,552,678
Medicare Integrity Program – Provider Education and Training	175,293
Provider Audit	14,503,376
Non-Renewals	<u>1,933,021</u>
 Total Costs Claimed on FACP	 \$58,240,018
 <u>Recommended Adjustments</u>	
Executive Compensation	\$ 22,428
Guarantee Fees	17,159
Corporate Overhead Adjustment	<u>22,414</u>
 Total Recommended Adjustments	 \$ 62,001
 Total Recommended for Acceptance	 <u>\$58,178,017</u>

NOTE: Explanation for each adjustment is provided in the FINDINGS AND RECOMMENDATIONS section of this report.

EXHIBIT C

UNITED GOVERNMENT SERVICES, LLC
 FINAL ADMINISTRATIVE COST PROPOSAL
 AND THE AUDITORS RECOMMENDATIONS
 FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 2001

<u>Medicare Activity Description</u>	<u>Administrative Costs</u>
Bills/Claims Payment	\$24,957,368
Appeals/Review	6,458,747
Inquiries	4,255,713
Program Management – Provider Education and Training	1,770,244
Reimbursement	6,495,049
Productivity Investments	109,001
Provider Telephone Inquiries	2,888,115
Complimentary Credits	(2,512,422)
Medical Review	11,895,688
Medicare Secondary Payer	7,022,846
Benefits Integrity	2,757,261
Medicare Integrity Program – Provider Education and Training	638,014
Provider Audit	30,542,933
Non-Renewals	<u>2,047,198</u>
 Total Costs Claimed on FACP	 \$99,325,755
 <u>Costs Excluded From Audit Scope</u>	
 Pension Costs	 \$ 1,161,723
 <u>Recommended Adjustments</u>	
 Executive Compensation	 \$ 50,321
Guarantee Fees	<u>30,088</u>
 Total Recommended Adjustments	 \$ 80,409
 Total Recommended for Acceptance	 <u><u>\$98,083,623</u></u>

NOTE: Explanation for each adjustment is provided in the FINDINGS AND RECOMMENDATIONS section of this report.

ACKNOWLEDGMENTS

This report was prepared under the direction of Paul Swanson, Regional Inspector General for Audit Services. Other principal Office of Audit Services staff who contributed include:

Robert Wiedeman, *Audit Manager*

Cyndi Owens, *Senior Auditor*

David Mellem, *Auditor*

Wendy Mahaney, *Auditor*

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