

**Memorandum**

Date JUL 7 1993

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

Subject Review of Subsidiary Administrative Costs Claimed Under Parts A and B of the Health Insurance Program for the Aged and Disabled by Blue Cross and Blue Shield of Michigan (A-05-93-00057)

To

Bruce C. Vladeck
Administrator
Health Care Financing Administration

This memorandum alerts you to the issuance on July 9, 1993, of our final audit report. This report was prepared under an audit contract with the certified public accounting firm, Foxx & Company. A copy is attached.

Subsidiary administrative costs claimed by Blue Cross and Blue Shield of Michigan (BCBSM) for the period October 1, 1980 through September 30, 1987 under Parts A and B of the Health Insurance Program for the Aged and Disabled contained \$1,409,954 recommended for financial adjustment. The recommended financial adjustment pertains to unallowable costs and profits related to BCBSM's three subsidiaries.

We are recommending that BCBSM make the appropriate financial adjustment to the final administrative cost proposals submitted for the years audited. The auditee concurred with our findings and recommendation. Regional Health Care Financing Administration officials also generally concurred with our recommendation.

For further information, contact:
Martin D. Stanton
Regional Inspector General
for Audit Services, Region V
(312) 353-2618

Attachment

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF SUBSIDIARY
ADMINISTRATIVE COSTS CLAIMED
UNDER PARTS A AND B OF THE
HEALTH INSURANCE PROGRAM FOR
THE AGED AND DISABLED**

**BLUE CROSS AND BLUE SHIELD OF
MICHIGAN**



JULY 1993 A-05-93-00057



DEPARTMENT OF HEALTH AND HUMAN SERVICES

REGION V
105 W. ADAMS ST.
CHICAGO, ILLINOIS 60603-6201

OFFICE OF
INSPECTOR GENERAL

Common Identification No. A-05-93-00057

Ms. Rosalee Livingston
Vice President, Government Business Group
600 Lafayette East
Detroit, Michigan 48226

Dear Ms. Livingston:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), Office of Audit Services (OAS) final audit report entitled "Review of Subsidiary Administrative Costs Claimed Under Parts A and B of the Health Insurance Program for the Aged and Disabled for the period October 1, 1980 through September 30, 1987". The report was prepared under an audit contract with the CPA firm Foxx & Company. A copy of this report will be forwarded to the action official noted below for her review and any action deemed necessary.

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

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS audit reports issued to the Department's grantees or contractors are made available, if requested, 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 the Common Identification Number A-05-93-00057 in all correspondence relating to this report.

Sincerely yours,

Martin D. Stanton
Regional Inspector General
for Audit Services

Enclosures

Judith Stec
Associate Regional Administrator
Division of Medicare

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

REPORT ON REVIEW OF SUBSIDIARY ADMINISTRATIVE COSTS CLAIMED
UNDER THE HEALTH INSURANCE PROGRAM FOR THE AGED AND DISABLED
MEDICARE PART A
MEDICARE PART B

AGREEMENT NOS. HCFA 80-001-1.25 AND HCFA 80-016-2
FOR THE PERIOD OCTOBER 1, 1980 TO SEPTEMBER 30, 1984
AGREEMENT NOS. HCFA 84-001-1.25 AND HCFA 84-016-2
FOR THE PERIOD OCTOBER 1, 1984 TO SEPTEMBER 30, 1987

This report is made pursuant to contract HHS-100-88-0011 awarded on a competitive basis to Foxx & Company, 700 Goodall Complex, 324 West Ninth Street, Cincinnati, Ohio, 45202. The Department of Health and Human Services (HHS) Project Officer was Barbara Burdette, Office of Inspector General, Office of Audit, Region V, 26th Floor, 105 West Adams Street, Chicago, Illinois, 60604. The person employed by Foxx & Company with managerial and professional responsibility for the content and preparation of the report is Martin W. O'Neill.

The designation of financial and/or management practices as questionable or recommendation for financial adjustment of costs claimed, as well as other conclusions and recommendations in this report, represent the findings of Foxx & Company, CPAs. Final determinations on these matters will be made by authorized HHS principal operating component officials.

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SUMMARY OF RESULTS

A total of \$16,050,166 in subsidiary costs was disclaimed in the prior Medicare audit reports of Blue Cross and Blue Shield of Michigan (BCBSM) for the period October 1, 1980 to September 30, 1987. These audits were performed by several CPA firms contracted by the U.S. Department of Health and Human Services, Office of Inspector General. The subsidiary costs disclaimed in the prior Medicare reports were estimated amounts based on application of the corporate-wide Medicare allocation rates to the subsidiaries' sales to BCBSM in the subsidiaries' audited financial statements. Accordingly, we requested BCBSM to reconstruct the subsidiary costs actually claimed to the Medicare program based on BCBSM's job cost accounting records.

BCBSM recalculated the subsidiary costs claimed to the Medicare Program as follows:

<u>Fiscal Year</u>	<u>BCBSM Recalculated Subsidiary Cost Claimed</u>		
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>
1981	\$ 68,716	\$ 24,579	\$ 93,295
1982	160,534	209,444	369,978
1983	302,298	860,392	1,162,690
1984	534,904	838,528	1,373,432
1985	1,238,462	2,510,508	3,748,970
1986	1,313,913	2,071,856	3,385,769
1987	<u>1,286,956</u>	<u>2,929,743</u>	<u>4,216,699</u>
Total	<u>\$4,905,783</u>	<u>\$9,445,050</u>	<u>\$14,350,833</u>

According to BCBSM's calculations, \$14,350,833 in subsidiary costs was claimed to the Medicare Program. This amount differs from the \$16,050,166 disclaimed in the prior Medicare audit reports by the amount that the actual subsidiary cost allocations differed from the standard Medicare percentages used in the Medicare audit reports. Another explanation for the difference is that the prior Medicare audit reports disclaimed amounts for services which were not charged at all to Medicare. The prior audit reports applied the standard Medicare percentage to all subsidiary costs, regardless of whether Medicare was charged for the service.

BCBSM's recalculated subsidiary costs claimed to the Medicare Program were reviewed and noted adjustments were corrected. Based on our review of the \$14,350,833 in recalculated subsidiary costs claimed, a total of \$1,409,954 has been recommended for financial adjustment. The \$1,409,954 recommended for financial adjustment is comprised of the following:

	Amount Recommended For Financial Adjustment		
	Medicare Part A	Medicare Part B	Total
Profit	\$433,218	\$802,489	\$1,235,707
Ineligible costs	57,099	117,148	174,247
Total	<u>\$490,317</u>	<u>\$919,637</u>	<u>\$1,409,954</u>

INTRODUCTION

Background

The Social Security Amendments of 1965 added two related health insurance programs to the Social Security Act for persons aged 65 and older. These programs, referred to as Medicare, included:

- Part A - A basic plan, set out in Part A of Title XVIII of the Act, providing insurance protection against the cost of hospital and related care.
- Part B - A voluntary supplementary plan, set out in Part B of Title XVIII of the Act, providing insurance protection against the cost of medical and other health services not covered under Part A.

The Social Security Amendments of 1972 extended Medicare benefits to individuals who have received social security cash benefits for at least 24 consecutive months because they are disabled and eligible individuals under age 65 suffering from chronic renal disease so severe as to require a regular course of dialysis or kidney transplant.

The Medicare Program is administered by the Health Care Financing Administration (HCFA), which is part of the Department of Health and Human Services. Title XVIII provides that public or private organizations, known as intermediaries for Part A and carriers for Part B, may assist in the Program's administration.

Blue Cross and Blue Shield of Michigan (BCBSM) was the subcontractor to the Blue Cross and Blue Shield Association as an intermediary for Part A and was contracted by the HCFA as a carrier for Part B in Michigan.

The administrative costs claimed by BCBSM for the period October 1, 1980 to September 30, 1987 include costs for services provided by wholly owned subsidiaries of BCBSM. The subsidiaries were:

- Diversified Technologies Incorporated (Diversitec)
- Blue Ribbon, Inc. (Blue Ribbon)
- H.C. Real Estate Company (H.C. Real Estate)
- Tower Management Company (Tower Management)

Three previous audits of administrative costs claimed by BCBSM to Medicare Parts A and B for the period October 1, 1980 through September 30, 1987, which were performed by other CPA firms, disclaimed an opinion on the costs billed by the subsidiaries and recommended the profit billed for financial adjustment, detailed as follows:

	Costs Disclaimed			Profit Recommended for Financial Adjustment		
	Part A	Part B	Total	Part A	Part B	Total
Diversitec:						
1981	\$ 62,366	\$ 22,308	\$ 84,674	\$ 6,350	\$ 2,271	\$ 8,621
1982	145,701	190,091	335,792	14,833	19,353	34,186
1983	274,366	780,892	1,055,258	27,932	79,500	107,432
1984	197,492	688,077	885,569	54,508	189,923	244,431
1985	796,694	1,208,067	2,004,761	157,306	238,933	396,239
1986	745,287	1,516,968	2,262,255	34,397	70,013	104,410
1987	962,270	1,893,161	2,855,431	-	-	-
Total	<u>\$3,184,176</u>	<u>\$ 6,299,564</u>	<u>\$ 9,483,740</u>	<u>\$295,326</u>	<u>\$ 599,993</u>	<u>\$ 895,319</u>
Blue Ribbon:						
1984	\$ 7,290	\$ 137,523	\$ 144,813	\$ 2,398	\$ 46,555	\$ 48,953
1985	11,927	224,934	236,861	4,119	79,945	84,064
1986	64,739	131,769	196,508	62,857	127,941	190,798
1987	73,560	140,565	214,125	16,487	36,592	53,079
Total	<u>\$ 157,516</u>	<u>\$ 634,791</u>	<u>\$ 792,307</u>	<u>\$ 85,861</u>	<u>\$ 291,033</u>	<u>\$ 376,894</u>
H.C. Real Estate:						
1985	\$ 248,269	\$ 529,645	\$ 777,914	\$ 13,066	\$ 27,876	\$ 40,942
1986	644,080	1,310,972	1,955,052	13,154	26,773	39,927
1987	875,092	1,715,679	2,590,771	23,676	52,549	76,225
Total	<u>\$1,767,441</u>	<u>\$ 3,556,296</u>	<u>\$ 5,323,737</u>	<u>\$ 49,896</u>	<u>\$ 107,198</u>	<u>\$ 157,094</u>
Tower Management:						
1986	\$ 88,650	\$ 180,440	\$ 269,090	\$ 8,194	\$ 16,678	\$ 24,872
1987	61,780	119,512	181,292	8,070	17,910	25,980
Total	<u>\$ 150,430</u>	<u>\$ 299,952</u>	<u>\$ 450,382</u>	<u>\$ 16,264</u>	<u>\$ 34,588</u>	<u>\$ 50,852</u>
Grand Total	<u>\$5,259,563</u>	<u>\$10,790,603</u>	<u>\$16,050,166</u>	<u>\$447,347</u>	<u>\$1,032,812</u>	<u>\$1,480,159</u>

The subsidiary costs disclaimed and the profit recommended for financial adjustment in the prior Medicare audit reports differ from the recalculated costs claimed and the profits recommended for financial adjustment in this report. The prior Medicare audit

reports estimated the costs billed to Medicare by the four subsidiaries based on the application of corporate-wide Medicare allocation rates to the sales to BCBSM in the subsidiaries' audited financial statements. The profit recommended for financial adjustment in the prior Medicare reports was calculated by applying the profit margin in the subsidiaries' audited financial statements to the subsidiary costs disclaimed. However, in determining the profits and ineligible costs charged to the Medicare program for this review, BCBSM reconstructed the subsidiary costs charged to the Medicare program based on subsidiary invoices, general ledgers, and cost center allocation rates. These recalculated costs claimed were reviewed for accuracy and ineligible costs and were then applied to departmental profit margins of the subsidiaries.

Scope of Review

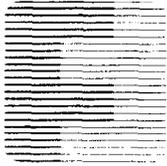
We have reviewed Exhibits A through H which summarize subsidiary costs disclaimed in prior Medicare audit reports of BCBSM for the period October 1, 1980 through September 30, 1987:

<u>Period</u>	<u>HHS Audit Report Disclaimed Costs</u>		
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>
1981	\$ 62,366	\$ 22,308	\$ 84,674
1982	145,701	190,091	335,792
1983	274,366	780,892	1,055,258
1984	204,782	825,600	1,030,382
1985	1,056,890	1,962,646	3,019,536
1986	1,542,756	3,140,149	4,682,905
1987	<u>1,972,702</u>	<u>3,868,917</u>	<u>5,841,619</u>
	<u>\$5,259,563</u>	<u>\$10,790,603</u>	<u>\$16,050,166</u>

Our review was conducted in accordance with the Government Auditing Standards (1988 Revision) issued by the Comptroller General of the United States to the extent practicable because this was an agreed-upon procedure review. The purpose of our review was to determine whether the subsidiary costs claimed were reasonable, allowable, and incurred in conformance with applicable laws, regulations and guidelines, and the terms of the agreements entered into between HHS and BCBSM.

Discussion of Results of Agreed-Upon Procedures

A draft report was sent to Blue Cross and Blue Shield of Michigan (BCBSM) on February 15, 1993. BCBSM provided a response to the draft report in a letter dated April 14, 1993, which is included in its entirety as Exhibit I. BCBSM agreed with the findings in the draft report. A final exit conference was held with Mr. Louis Gorning, Director of Government Budget & Planning, on April 15, 1993. Mr. Gorning was informed that the \$1,409,954 questioned in the draft report would remain in the final report.



Foxx & Company
Certified Public Accountants

Office of Inspector General
U.S. Department of Health and
Human Services
105 West Adams Street
Chicago, Illinois 60604

We have applied certain agreed-upon procedures as discussed in the following paragraph to the subsidiary costs disclaimed in prior Medicare audit reports of Blue Cross and Blue Shield of Michigan (BCBSM), Detroit, Michigan, for the period October 1, 1980 to September 30, 1987, as summarized in Exhibits A through H. The agreed-upon procedures were performed solely for the purpose of assisting and providing information to the U.S. Department of Health and Human Services, Office of Inspector General (HHS-OIG), in evaluating the subsidiary costs disclaimed. The following regulations were used as guidance in our review: a) Government Auditing Standards (1988 Revision) issued by the Comptroller General of the United States to the extent practicable; b) Part 31 of the Federal Acquisition Regulations (FAR); c) Part 1-15.2 of the Federal Procurement Regulations (FPR); and d) Appendix B of the Medicare Agreements.

The agreed-upon procedures performed were as follows:

1. Reviewed BCBSM's reconstruction schedules of subsidiary costs claimed.
2. Reviewed the subsidiary costs billed to BCBSM for costs in excess of the actual costs incurred by the subsidiaries.
3. Determined whether ineligible costs were billed to BCBSM by the subsidiaries.

The findings resulting from our review are discussed in Exhibits A through H of this report.

Because the above procedures do not constitute an audit made in accordance with generally accepted auditing standards, we do not express an opinion on Exhibits A through H. In connection with the procedures referred to above, except as set forth in Exhibits A through H, no matters came to our attention that caused us to believe that the subsidiary costs claimed by BCBSM might require adjustment. Had we performed additional procedures or had we made an examination of the financial statements in accordance with generally accepted auditing standards, other matters might have come to our attention that would have been reported to you.

This report relates to the subsidiary costs disclaimed in prior Medicare audit reports of BCBSM as summarized in Exhibits A through H and does not extend to any financial statements of BCBSM taken as a whole.

Fox & Company

May 1, 1992

EXHIBIT A

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SUMMARY OF REVIEW RESULTS

for the period October 1, 1980 through September 30, 1987

Fiscal Year	HHS Audit Report			BCBSM Recalculated Subsidiary Costs Claimed	Amount Recommended for Financial Adjustment	Reference
	Disclaimed Costs	Profit Recommended for Financial Adjustment	Total			
1981	\$ 84,674	\$ 8,621	\$ 93,295	\$ 93,295	\$ 370	Exhibit B
1982	335,792	34,186	369,978	369,978	13,458	Exhibit C
1983	1,055,258	107,432	1,162,690	1,162,690	120,998	Exhibit D
1984	1,030,382	293,384	1,323,766	1,373,432	218,022	Exhibit E
1985	3,019,536	521,245	3,540,781	3,748,970	472,613	Exhibit F
1986	4,682,905	360,007	5,042,912	3,385,769	224,410	Exhibit G
1987	5,841,619	155,284	5,996,903	4,216,699	360,083	Exhibit H
Total	<u>\$16,050,166</u>	<u>\$1,480,159</u>	<u>\$17,530,325</u>	<u>\$14,350,833</u>	<u>\$1,409,954</u>	

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SUMMARY OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1980 through September 30, 1981

	<u>HHS Audit Report</u>			<u>BCBSM Recalculated Subsidiary Costs Claimed</u>	<u>Amount Recommended for Financial Adjustment</u>	<u>Reference</u>
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
<u>Medicare</u>						
Part A	\$62,366	\$6,350	\$68,716	\$68,716	\$272	Exhibit B-1
Part B	<u>22,308</u>	<u>2,271</u>	<u>24,579</u>	<u>24,579</u>	<u>98</u>	Exhibit B-2
	<u>\$84,674</u>	<u>\$8,621</u>	<u>\$93,295</u>	<u>\$93,295</u>	<u>\$370</u>	

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART A
for the period October 1, 1980 through September 30, 1981

<u>subsidiary</u>	<u>HHS Audit Report</u>			<u>BCBSM Recalculated Subsidiary Costs Claimed</u>	<u>Amount Recommended for Financial Adjustment</u>	<u>Reference</u>
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
Diversified Technologies Incorporated	<u>\$62,366</u>	<u>\$6,350</u>	<u>\$68,716</u>	<u>\$68,716</u>	<u>\$272</u>	Schedule B-1

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART B
for the period October 1, 1980 through September 30, 1981

Subsidiary	HHS Audit Report			BCBSM Recalculated Subsidiary Costs Claimed	Amount Recommended for Financial Adjustment	Reference
	Disclaimed Costs	Profit Recommended for Financial Adjustment	Total			
Diversified Technologies Incorporated	<u>\$22,308</u>	<u>\$2,271</u>	<u>\$24,579</u>	<u>\$24,579</u>	<u>\$98</u>	- Schedule B-1

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF DIVERSIFIED TECHNOLOGIES INCORPORATED RECALCULATED COSTS CLAIMED
AND AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1980 through September 30, 1981

<u>Service</u>	<u>Recalculated Costs Claimed</u>			<u>Amount Recommended For Financial Adjustment</u>			<u>Note</u>
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	
Data entry	\$ -	\$24,579	\$24,579	\$ -	\$98	\$ 98	1
Computer usage	<u>68,716</u>	<u>-</u>	<u>68,716</u>	<u>272</u>	<u>-</u>	<u>272</u>	1
Total	<u>\$68,716</u>	<u>\$24,579</u>	<u>\$93,295</u>	<u>\$272</u>	<u>\$98</u>	<u>\$370</u>	

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE B-1

for the period October 1, 1980 through September 30, 1981

NOTE 1 - INELIGIBLE COSTS

The \$370 recommended for financial adjustment represents ineligible costs billed by Diversified Technologies Incorporated (Diversitec) to Blue Cross and Blue Shield of Michigan (BCBSM). BCBSM was unable to provide Diversitec's expense general ledgers for 1981. Therefore, the audited financial statements were obtained to determine whether ineligible costs were claimed. The following ineligible costs were noted:

Ineligible costs:	
Bad debt expense	<u>\$14,000</u>

According to 48 CFR 31.205-3:

Bad debts. . . and any directly associated costs such as collection costs, and legal costs are unallowable.

Because Diversitec did not maintain cost records, the ineligible costs were allocated to the Medicare Program based on a percentage of costs charged to the Medicare Program for each service to the total Diversitec revenues.

Therefore, \$370 has been recommended for financial adjustment in accordance with 48 CFR 31.205-3, calculated as follows:

Service	Total Ineligible Costs	Diversitec Revenues	Medicare Part A		Medicare Part B		Allocated Ineligible Costs	Total Recommended for Financial Adjustment
			Amount Charged	Percent Charged	Amount Charged	Percent Charged		
Data entry	\$14,000	\$3,536,541	\$ -	0.00%	\$ -	\$24,579	\$98	\$ 98
Computer Usage	14,000	3,536,541	<u>68,716</u>	1.94%	<u>272</u>	-	-	<u>272</u>
Total			<u>\$68,716</u>		<u>\$272</u>	<u>\$24,579</u>	<u>\$98</u>	<u>\$370</u>

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SUMMARY OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1981 through September 30, 1982

	<u>HHS Audit Report</u>			<u>BCBSM Recalculated Subsidiary Costs Claimed</u>	<u>Amount Recommended for Financial Adjustment</u>	<u>Reference</u>
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
<u>Medicare</u>						
Part A	\$145,701	\$14,833	\$160,534	\$160,534	\$ 5,833	Exhibit C-1
Part B	<u>190,091</u>	<u>19,353</u>	<u>209,444</u>	<u>209,444</u>	<u>7,625</u>	Exhibit C-2
	<u>\$335,792</u>	<u>\$34,186</u>	<u>\$369,978</u>	<u>\$369,978</u>	<u>\$13,458</u>	

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART A
for the period October 1, 1981 through September 30, 1982

<u>Subsidiary</u>	<u>HHS Audit Report</u>			<u>BCBSM Recalculated Subsidiary Costs Claimed</u>	<u>Amount Recommended for Financial Adjustment</u>	<u>Reference</u>
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
Diversified Technologies Incorporated	<u>\$145,701</u>	<u>\$14,833</u>	<u>\$160,534</u>	<u>\$160,534</u>	<u>\$5,833</u>	Schedule C-1

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART B
for the period October 1, 1981 through September 30, 1982

<u>Subsidiary</u>	<u>HHS Audit Report</u>			<u>BCBSM Recalculated Subsidiary Costs Claimed</u>	<u>Amount Recommended for Financial Adjustment</u>	<u>Reference</u>
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
Diversified Technologies Incorporated	<u>\$190,091</u>	<u>\$19,353</u>	<u>\$209,444</u>	<u>\$209,444</u>	<u>\$7,625</u>	Schedule C-1

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF DIVERSIFIED TECHNOLOGIES INCORPORATED RECALCULATED COSTS CLAIMED
AND AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1981 through September 30, 1982

<u>Service</u>	<u>Recalculated Costs Claimed</u>			<u>Amount Recommended For Financial Adjustment</u>			<u>Note</u>
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	
Data entry	\$ 3,355	\$135,749	\$139,104	\$ 125	\$4,945	\$ 5,070	1
Computer usage	128,061	-	128,061	4,653	-	4,653	1
service department	27,059	67,597	94,656	986	2,458	3,444	1
User printing	<u>2,059</u>	<u>6,098</u>	<u>8,157</u>	<u>69</u>	<u>222</u>	<u>291</u>	1
	<u>\$160,534</u>	<u>\$209,444</u>	<u>\$369,978</u>	<u>\$5,833</u>	<u>\$7,625</u>	<u>\$13,458</u>	

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

NOTES TO SCHEDULE C-1

for the period October 1, 1981 through September 30, 1982

NOTE 1 - INELIGIBLE COSTS

The \$13,458 recommended for financial adjustment represents ineligible costs billed by Diversified Technologies Incorporated (Diversitec) to Blue Cross Blue Shield of Michigan (BCBSM). BCBSM was unable to provide Diversitec's expense general ledgers for 1982. Therefore, the audited financial statements were obtained to determine whether ineligible costs were claimed. The following ineligible costs were noted in the 1982 audited financial statements:

Ineligible costs:	
Advertising	\$ 57,360
Bad debt expense	<u>81,535</u>
Total ineligible costs	<u>\$138,895</u>

According to 48 CFR 31.205-1:

(c) Advertising costs. . . are unallowable.

In addition, 48 CFR 31.205-3 states that:

Bad debts. . .and any directly associated costs such as collection costs, and legal costs are unallowable.

Also, advertising costs are specifically unallowable in accordance with Paragraph XV of Appendix B to the Medicare Agreement. Because Diversitec did not maintain cost records, the ineligible costs were allocated to the Medicare Program based on a percentage of costs charged for each service to the Medicare Program to total Diversitec revenues.

Therefore, \$13,458 has been recommended for financial adjustment in accordance with Appendix B, Paragraph XV and 48 CFR 31.205-1 and 31.205-3, calculated as follows:

NOTE 1 - INELIGIBLE COSTS (continued)

<u>Service</u>	<u>Total Ineligible Costs</u>	<u>Diversitec Revenues</u>	<u>Medicare Part A</u>		<u>Medicare Part B</u>			<u>Total Recommended for Financial Adjustment</u>	
			<u>Amount Charged</u>	<u>Percent Charged</u>	<u>Allocated Ineligible Costs</u>	<u>Amount Charged</u>	<u>Percent Charged</u>		<u>Allocated Ineligible Costs</u>
Data entry	\$138,895	\$3,817,415	\$ 3,355	0.09%	\$ 125	\$135,749	3.56%	\$4,945	\$ 5,070
Computer usage	138,895	3,817,415	128,061	3.35%	4,653	-	0.00%	-	4,653
Service department	138,895	3,817,415	27,059	0.71%	986	67,597	1.77%	2,458	3,444
User printing	138,895	3,817,415	2,059	0.05%	69	6,098	0.16%	222	291
Total			<u>\$160,534</u>		<u>\$5,833</u>	<u>\$209,444</u>		<u>\$7,625</u>	<u>\$13,458</u>

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SUMMARY OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1982 through September 30, 1983

	<u>HHS Audit Report</u>			BCBSM Recalculated Subsidiary Costs Claimed	Amount Recommended for Financial Adjustment	Reference
	<u>Disclaimed Costs</u>	Profit Recommended for Financial Adjustment	<u>Total</u>			
<u>Medicare</u>						
Part A	\$ 274,366	\$ 27,932	\$ 302,298	\$ 302,298	\$ 31,453	Exhibit D-1
Part B	<u>780,892</u>	<u>79,500</u>	<u>860,392</u>	<u>860,392</u>	<u>89,545</u>	Exhibit D-2
	<u>\$1,055,258</u>	<u>\$107,432</u>	<u>\$1,162,690</u>	<u>\$1,162,690</u>	<u>\$120,998</u>	

Note 1: The amount recommended for financial adjustment in this report differs from the amount recommended for financial adjustment in the HHS audit report because the HHS audit report applied a 9.24 percent profit margin to the total subcontractor costs for Fiscal Years 1981, 1982 and 1983. The profit margin should have been applied only to the FY 1983 subcontractor costs.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART A
for the period October 1, 1982 through September 30, 1983

Subsidiary	HHS Audit Report			BCBSM Recalculated Subsidiary Costs Claimed	Amount Recommended for Financial Adjustment	Reference
	Disclaimed Costs	Profit Recommended for Financial Adjustment	Total			
Diversified Technologies Incorporated	<u>\$274,366</u>	<u>\$27,932</u>	<u>\$302,298</u>	<u>\$302,298</u>	<u>\$31,453</u>	~ Schedule D-1

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART B
for the period October 1, 1982 through September 30, 1983

<u>Subsidiary</u>	<u>HHS Audit Report</u>			<u>BCBSM Recalculated Subsidiary Costs Claimed</u>	<u>Amount Recommended for Financial Adjustment</u>	<u>Reference</u>
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
Diversified Technologies Incorporated	<u>\$780,892</u>	<u>\$79,500</u>	<u>\$860,392</u>	<u>\$860,392</u>	<u>\$89,545</u>	Schedule D-1

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF DIVERSIFIED TECHNOLOGIES INCORPORATED RECALCULATED COSTS CLAIMED
AND AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1982 through September 30, 1983

Service	Recalculated Costs Claimed			Amount Recommended For Financial Adjustment			Notes
	Medicare Part A	Medicare Part B	Total	Medicare Part A	Medicare Part B	Total	
Data entry	\$ 59,614	\$332,569	\$ 392,183	\$ 6,185	\$34,600	\$ 40,785	1
Computer usage	18,916	14,359	33,275	1,989	1,501	3,490	1
Systems & programs	223	931	1,154	13	111	124	1
Service department	188,060	418,264	606,324	19,594	43,523	63,117	1
User printing	35,485	85,713	121,198	3,672	8,924	12,596	1
Other	-	8,556	8,556	-	886	886	1
Total	<u>\$302,298</u>	<u>\$860,392</u>	<u>\$1,162,690</u>	<u>\$31,453</u>	<u>\$89,545</u>	<u>\$120,998</u>	

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE D-1

for the period October 1, 1982 through September 30, 1983

NOTE 1 - COSTS RECOMMENDED FOR FINANCIAL ADJUSTMENT - \$120,998

The \$120,998 recommended for financial adjustment is comprised of the following:

	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Reference</u>
Profit billed	\$17,050	\$48,527	\$ 65,577	1a
Ineligible costs	<u>14,403</u>	<u>41,018</u>	<u>55,421</u>	1b
Total	<u>\$31,453</u>	<u>\$89,545</u>	<u>\$120,998</u>	

- a. The \$65,577 recommended for financial adjustment represents profit billed by Diversified Technologies Incorporated (Diversitec) to Blue Cross Blue Shield of Michigan (BCBSM) for administrative services provided for the Medicare Program. Diversitec's job cost system did not permit comparison of actual costs to the amount billed. In addition, a profit margin by service could not be calculated because the information was not available. Therefore, the audited financial statements were obtained and a profit margin was calculated, detailed as follows:

<u>1983 Diversitec Financial Statements</u>			
<u>Revenues</u>	<u>Expenses</u>	<u>Net Income</u>	<u>Profit Margin</u>
<u>\$12,083,421</u>	<u>\$11,401,730</u>	<u>\$681,691</u>	<u>5.64%*</u>

- * The HHS audit report for FY 1983 used a 9.24 percent profit margin. The HHS audit report excluded the unallowable expense and interest income. We have incorporated the adjustment for unallowable expenses as a separate finding under Note 2.

According to Medicare Part A Agreement No. HCFA 80-001-1.25, Article XV, and Medicare Part B Agreement No. HCFA 80-016-2, Article XIX, "Subcontracting":

- B. It is the policy of the Government to procure property and services from responsible sources

at fair and reasonable prices calculated to result in the lowest ultimate cost to the Government. In order to achieve this objective, competitive proposals shall be utilized to the maximum practical extent.

Because the subsidiaries were wholly-owned by the Auditee and competitive bidding was not applied, the lowest possible cost to Medicare would be the actual costs incurred by the subsidiaries.

Also, Article V in the Auditee's agreement with Diversitec (a wholly-owned subsidiary), Fees and Payment, states:

...all fees and charges for services to be provided by Diversitec pursuant to this Agreement shall be based upon and include only reasonable costs....

In addition, Articles XIII and XVI of the Medicare Part A and Part B Agreements respectively state:

A. It is the intent of this agreement that the Plan, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$65,577 has been recommended for financial adjustment in accordance with Medicare Agreement Nos. HCFA 80-001-1.25 and HCFA 80-016-2, calculated as follows:

Service	Recalculated Costs Claimed			Profit Margin	Amount Recommended For Financial Adjustment		
	Medicare Part A	Medicare Part B	Total		Medicare Part A	Medicare Part B	Total
Data entry	\$ 59,614	\$332,569	\$ 392,183	5.64%	\$ 3,362	\$18,757	\$22,119
Computer usage	18,916	14,359	33,275	5.64%	1,067	810	1,877
Systems and programs	223	931	1,154	5.64%	13	53	66
Service department	188,060	418,264	606,324	5.64%	10,607	23,590	34,197
User printing	35,485	85,713	121,198	5.64%	2,001	4,834	6,835
Other	-	8,556	8,556		-	483	483
Total	\$302,298	\$860,392	\$1,162,690		\$17,050	\$48,527	\$65,577

- b. The \$55,421 recommended for financial adjustment represents ineligible costs billed by Diversitec to BCBSM. BCBSM was unable to provide Diversitec's expense general ledgers for 1983. Therefore, the audited financial statements were obtained to determine whether ineligible costs were claimed. The following ineligible costs were noted in the 1983 audited financial statements:

Ineligible costs:	
Advertising	\$152,554
Bad debt expense	56,469
Interest	<u>367,079</u>
Total ineligible costs	<u>\$576,102</u>

According to 48 CFR 31.205-1:

(c) Advertising costs...are unallowable.

Also, 48 CFR 31.205-3 states:

Bad debts...and any directly associated costs such as collection costs, and legal costs are unallowable.

In addition, 48 CFR 31.205-20 states that:

Interest on borrowings (however represented), bond discounts, costs of financing and refinancing capital (net worth plus long term liabilities) ...are unallowable...

Advertising costs are specifically unallowable in accordance with Paragraph XV of Appendix B to the Medicare Agreement.

Because Diversitec did not maintain cost records, the ineligible costs were allocated to the Medicare Program based on a percentage of costs charged for each service to the Medicare Program related to total Diversitec revenues.

Therefore, \$55,421 has been recommended for financial adjustment in accordance with Appendix B, Paragraph XV and 48 CFR 31.205-1, 31.205-3, and 31.205-20, calculated as follows:

Service	Total Ineligible Costs	Diversitec Revenues	Medicare Part A		Medicare Part B		Total Recommended for Financial Adjustment		
			Amount Charged	Percent Charged	Allocated Ineligible Costs	Amount Charged		Percent Charged	Allocated Ineligible Costs
Data entry	\$576,102	\$12,083,421	\$ 59,614	0.49%	\$ 2,823	\$332,569	2.75%	\$15,843	\$18,666
Computer usage	576,102	12,083,421	18,916	0.16%	922	14,359	0.12%	691	1,613
Systems and programs	576,102	12,083,421	223	0.00%	-	931	0.01%	58	58
Service department	576,102	12,083,421	188,060	1.56%	8,987	418,264	3.46%	19,933	28,920
User printing	576,102	12,083,421	35,485	0.29%	1,671	85,713	0.71%	4,090	5,761
Other	576,102	12,083,421	-	0.00%	-	8,556	0.07%	403	403
Total			<u>\$302,298</u>		<u>\$14,403</u>	<u>\$860,392</u>		<u>\$41,018</u>	<u>\$55,421</u>

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SUMMARY OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1983 through September 30, 1984

	<u>HHS Audit Report</u>			BCBSM Recalculated Subsidiary Costs Claimed	Amount Recommended for Financial Adjustment (Note 1)	Reference
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
<u>Medicare</u>						
Part A	\$ 204,782	\$ 56,906	\$ 261,688	\$ 534,904	\$ 84,571	Exhibit E-1
Part B	<u>825,600</u>	<u>236,478</u>	<u>1,062,078</u>	<u>838,528</u>	<u>133,451</u>	Exhibit E-2
	<u>\$1,030,382</u>	<u>\$293,384</u>	<u>\$1,323,766</u>	<u>\$1,373,432</u>	<u>\$218,022</u>	

Note 1: The amount recommended for financial adjustment in this report differs from the amount recommended for financial adjustment in the HHS audit report because 1) the subsidiary costs claimed have been recalculated by BCBSM (according to BCBSM, these costs are the actual costs claimed based on their job cost accounting records); and 2) for Diversitec, we have calculated the profit margin for each respective service rather than computing a consolidated profit margin. The other CPA firms calculated the profit margin on the entire business. Because the subsidiaries did not allocate all of their services to BCBSM, the profit allocated by the other CPA firms would be overstated.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART A
for the period October 1, 1983 through September 30, 1984

<u>Subsidiary</u>	<u>HHS Audit Report</u>			<u>BCBSM Recalculated Subsidiary Costs Claimed</u>	<u>Amount Recommended for Financial Adjustment</u>	<u>Reference</u>
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
Diversified Technologies Incorporated	\$197,492	\$ 54,508	\$252,000	\$527,816	\$83,651	Schedule E-1
Blue Ribbon, Inc.	7,290	2,398	9,688	7,088	920	Schedule E-2
Total	<u>\$204,782</u>	<u>\$ 56,906</u>	<u>\$261,688</u>	<u>\$534,904</u>	<u>\$84,571</u>	

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART B
for the period October 1, 1983 through September 30, 1984

<u>Subsidiary</u>	<u>HHS Audit Report</u>			<u>BCBSM Recalculated Subsidiary Costs Claimed</u>	<u>Amount Recommended for Financial Adjustment</u>	<u>Reference</u>
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
Diversified Technologies Incorporated	\$688,077	\$189,923	\$ 878,000	\$823,089	\$131,447	Schedule E-1
Blue Ribbon, Inc.	<u>137,523</u>	<u>46,555</u>	<u>184,078</u>	<u>15,439</u>	<u>2,004</u>	Schedule E-2
Total	<u>\$825,600</u>	<u>\$236,478</u>	<u>\$1,062,078</u>	<u>\$838,528</u>	<u>\$133,451</u>	

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF DIVERSIFIED TECHNOLOGIES INCORPORATED RECALCULATED COSTS CLAIMED
AND AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1983 through September 30, 1984

Service	Calculated Costs Claimed			Amount Recommended For Financial Adjustment			Notes
	Medicare Part A	Medicare Part B	Total	Medicare Part A	Medicare Part B	Total	
Equipment leasing	\$ 69,360	\$ 68,352	\$ 137,712	\$16,674	\$ 16,432	\$ 33,106	1
Information center	61,412	74,565	135,977	14,182	17,220	31,402	1
Disaster recovery	46,932	43,980	90,912	12,060	11,298	23,358	1
Automated input	149,244	238,488	387,732	356	569	925	1
Business assistance	30,744	34,368	65,112	637	709	1,346	1
Record services	45,300	95,664	140,964	7,666	16,188	23,854	1
Material and equipment management	82,392	177,852	260,244	27,087	58,471	85,558	1
Printing	42,432	89,820	132,252	4,989	10,560	15,549	1
Total	<u>\$527,816</u>	<u>\$823,089</u>	<u>\$1,350,905</u>	<u>\$83,651</u>	<u>\$131,447</u>	<u>\$215,098</u>	

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE E-1

for the period October 1, 1983 through September 30 1984

NOTE 1 - COSTS RECOMMENDED FOR FINANCIAL ADJUSTMENT - \$215,098

The \$215,098 recommended for financial adjustment is comprised of the following:

	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Reference</u>
Profit billed	\$81,076	\$128,211	\$209,287	Note 1a
Ineligible costs	<u>2,575</u>	<u>3,236</u>	<u>5,811</u>	Note 1b
	<u>\$83,651</u>	<u>\$131,447</u>	<u>\$215,098</u>	

a. The \$209,287 recommended for financial adjustment represents profit billed by Diversified Technologies Incorporated (Diversitec) to Blue Cross Blue Shield of Michigan (BCBSM) for administration of the Medicare Program. BCBSM claimed that adequate documentation did not exist to disclose the Diversitec costs billed by service. However, based on the invoices provided by BCBSM, Diversitec provided the following services to BCBSM:

- Equipment leasing
- Information center
- Disaster recovery
- Automated input
- Small EDP systems
- Record services
- Material and equipment management
- Printing

Diversitec's job cost system did not permit comparison of actual costs to the amount billed. Therefore, the Diversitec statement of operations reports were obtained for each responsibility center and a profit margin was calculated, detailed as follows:

<u>Service</u>	<u>Revenue</u>	<u>Expenses</u>	<u>Profit</u>	<u>Profit Margin</u>
Equipment leasing	\$ 1,804,530	\$1,370,740	\$ 433,790	24.04%
Information center	2,898,788	2,233,453	665,335	22.95%
Disaster recovery	2,375,411	1,821,338	554,073	23.33%
Record services	1,556,459	1,299,338	257,121	16.52%
Material and equipment management	1,894,567	1,273,470	621,097	32.78%
Printing	1,613,379	1,428,294	185,085	11.47%

According to Medicare Part A Agreement No. HCFA 80-001-1.25, Article XIII, and Medicare Part B Agreement No. HCFA 80-016-2, Article No. XVI:

- A. It is the intent of this agreement that the Plan, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$209,287 has been recommended for financial adjustment in accordance with Medicare Agreement Nos. HCFA 80-001-1.25 and HCFA 80-016-2, calculated as follows:

<u>Service</u>	<u>Recalculated Amount Claimed</u>			<u>Profit Margin</u>	<u>Amount Recommended For Financial Adjustment</u>		
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>		<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>
Equipment leasing	\$ 69,360	\$ 68,352	\$137,712	24.04%	\$16,674	\$16,432	\$ 33,106
Information center	61,412	74,565	135,977	22.95%	14,094	17,113	31,207
Disaster recovery	46,932	43,980	90,912	23.33%	10,949	10,260	21,209
Record services	45,300	95,664	140,964	16.52%	7,484	15,804	23,288
Material and equipment management	82,392	177,852	260,244	32.78%	27,008	58,300	85,308
Printing	42,432	89,820	132,252	11.47%	4,867	10,302	15,169
Total	<u>\$347,828</u>	<u>\$550,233</u>	<u>\$898,061</u>		<u>\$81,076</u>	<u>\$128,211</u>	<u>\$209,287</u>

b. The \$5,811 recommended for financial adjustment represents ineligible costs billed by Diversitec to BCBSM for the administration of the Medicare Program. As discussed in Note 1, adequate documentation did not exist to disclose the Diversitec costs billed by service. However, based on the invoices provided by BCBSM, the following costs were determined ineligible based on a review of the Diversitec statement of operations reports:

<u>Service</u>	<u>Ineligible Costs</u>		<u>Total</u>
	<u>Entertainment</u>	<u>Advertising</u>	
Information center	\$ 3,866	\$ 280	\$ 4,146
Disaster recovery	10,748	45,356	56,104
Automated input	3,016	416	3,432
Small EDP systems	-	65,037	65,037
Record services	2,020	4,230	6,250
Material and equipment management	1,494	332	1,826
Printing	<u>1,631</u>	<u>2,992</u>	<u>4,623</u>
Total	<u>\$22,775</u>	<u>\$118,643</u>	<u>\$141,118</u>

According to 48 CFR 31.205-1:

(c) Advertising costs...are unallowable

In addition, 48 CFR 31.205-14 states that:

Costs of amusement, diversion, social activities...are unallowable.

Because Diversitec did not maintain cost records, the ineligible costs were allocated to the Medicare Program based on a percentage of costs for services charged to the Medicare Program related to total Diversitec revenues.

Therefore, \$5,811 has been recommended for financial adjustment in accordance with 48 CFR 31.205-1 and 48 CFR 31.205-14, calculated as follows:

Service	Total Ineligible Costs	Diversitec Revenues	Medicare Part A		Medicare Part B		Allocated Ineligible Costs	Total Recommended for Financial Adjustment	
			Amount Charged	Percent Charged	Amount Charged	Percent Charged			
Information center	\$ 4,146	\$ 2,898,788	\$ 61,412	2.12%	\$ 88	\$ 74,565	2.57%	\$ 107	\$ 195
Disaster recovery	56,104	2,375,411	46,932	1.98%	1,111	43,980	1.85%	1,038	2,149
Automated input	3,432	1,439,420	149,244	10.37%	356	238,488	16.57%	569	925
Business assistance	65,037	3,147,098	30,744	0.98%	637	34,368	1.09%	709	1,346
Record services	6,250	1,556,459	45,300	2.91%	182	95,664	6.15%	384	566
Material and equipment management	1,826	1,894,567	82,392	4.35%	79	177,852	9.39%	171	250
Printing	4,623	1,613,379	42,432	2.63%	122	89,820	5.57%	258	380
Total	<u>\$141,418</u>	<u>\$14,925,122</u>	<u>\$458,456</u>		<u>\$2,575</u>	<u>\$754,737</u>		<u>\$3,236</u>	<u>\$5,811</u>

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF BLUE RIBBON, INC. RECALCULATED COSTS CLAIMED AND
AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1983 through September 30, 1984

<u>Service</u>	(Note 1) <u>Recalculated Amount Claimed</u>			Amount Recommended <u>For Financial Adjustment</u>			<u>Notes</u>
	<u>Medicare</u>	<u>Medicare</u>	<u>Total</u>	<u>Medicare</u>	<u>Medicare</u>	<u>Total</u>	
	<u>Part A</u>	<u>Part B</u>		<u>Part A</u>	<u>Part B</u>		
Various services	<u>\$7,088</u>	<u>\$15,439</u>	<u>\$22,527</u>	<u>\$920</u>	<u>\$2,004</u>	<u>\$2,924</u>	2,3

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE E-2

for the period October 1, 1983 through September 30, 1984

NOTE 1 - RECALCULATED COSTS CLAIMED

Medicare was charged a portion of the Blue Ribbon, Inc. (Blue Ribbon) costs that were charged to Cost Center No. 35410. Therefore, the activity posted to Cost Center No. 35410 was analyzed to determine the Blue Ribbon costs charged to Medicare. Detail of the recalculated costs claimed is as follows:

	Blue Ribbon Costs Charged to CC 35410	Medicare Allocation Rates		Allocated Costs	
		Part A	Part B	Part A	Part B
October 1983	\$ -	5.95%	12.90%	\$ -	\$ -
November 1983	3,014	5.51%	12.22%	166	368
December 1983	3,104	5.54%	12.49%	172	388
January 1984	31,482	5.35%	12.19%	1,684	3,838
February 1984	5,765	5.67%	12.32%	327	710
March 1984	10,442	5.56%	12.17%	581	1,271
April 1984	10,442	5.62%	11.97%	587	1,250
May 1984	20,884	5.66%	12.14%	1,182	2,535
June 1984	10,442	5.55%	11.93%	580	1,246
July 1984	10,442	5.51%	12.14%	575	1,268
August 1984	10,442	5.73%	12.17%	598	1,271
September 1984	<u>10,442</u>	6.09%	12.39%	<u>636</u>	<u>1,294</u>
Total	<u>\$126,901</u>			<u>\$7,088</u>	<u>\$15,439</u>

NOTE 2 - PROFIT

The \$2,924 recommended for financial adjustment represents profit billed by Blue Ribbon to Blue Cross and Blue Shield of Michigan (BCBSM). Blue Ribbon's job cost system did not permit comparison of actual costs to the amount billed. In addition, a profit margin by service could not be calculated because this information was not available. Therefore, the audited financial statements were obtained and a profit margin was calculated, detailed as follows:

NOTE 2 - PROFIT (continued)

Blue Ribbon 1984 Audited Financial Statements

<u>Revenues</u>	<u>Expenses</u>	<u>Net Income</u>	<u>Profit Margin</u>
<u>\$2,109,387</u>	<u>\$1,835,487</u>	<u>\$273,900</u>	<u>12.98%</u>

According to Medicare Agreement No. HCFA 80-001-1.25, Article No. XIII, and Medicare Agreement No. HCFA 80-016-2, Article No. XVI:

It is the intent of this agreement that the Plan, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$2,924 has been recommended for financial adjustment in accordance with Medicare Agreement Nos. HCFA 80-001-1.25 and HCFA 80-016-2, calculated as follows:

	<u>Recalculated Costs Claimed</u>			<u>Profit Margin</u>	<u>Amount Recommended For Financial Adjustment</u>		
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>		<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>
1983	\$ 338	\$ 756	\$ 1,094	12.98%*	\$ 44	\$ 98	\$ 142
1984	<u>6,750</u>	<u>14,683</u>	<u>21,433</u>	12.98%	<u>876</u>	<u>1,906</u>	<u>2,782</u>
Total	<u>\$7,088</u>	<u>\$15,439</u>	<u>\$22,527</u>		<u>\$920</u>	<u>\$2,004</u>	<u>\$2,924</u>

* BCBSM could not provide the Blue Ribbon 1983 audited financial statements. Therefore, the 1984 profit margin has been applied to the 1983 costs claimed.

NOTE 3 - INELIGIBLE COSTS

We were unable to perform a review to determine if ineligible costs were billed by Blue Ribbon in FY 1985. BCBSM was unable to provide Blue Ribbon expense general ledgers for 1984. In addition, the Blue Ribbon audited financial statements for 1984 did not provide a breakdown of the expenses. Therefore, we were unable to perform a review to determine if ineligible costs were billed.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SUMMARY OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1984 through September 30, 1985

	<u>HHS Audit Report</u>			BCBSM Recalculated Subsidiary Costs Claimed (Note 1)	Amount Recommended for Financial Adjustment	Reference
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
<u>Medicare</u>						
Part A	\$1,056,890	\$174,491	\$1,231,381	\$1,238,462	\$167,512	Exhibit F-1
Part B	<u>1,962,646</u>	<u>346,754</u>	<u>2,309,400</u>	<u>2,510,508</u>	<u>305,101</u>	Exhibit F-2
	<u>\$3,019,536</u>	<u>\$521,245</u>	<u>\$3,540,781</u>	<u>\$3,748,970</u>	<u>\$472,613</u>	

Note 1: The amount recommended for financial adjustment in this report differs from the amount recommended for financial adjustment in the HHS audit report because 1) the subsidiary costs claimed have been recalculated by BCBSM (according to BCBSM, these costs are the actual costs claimed based on their job cost accounting records); and 2) for Diversitec, we have calculated the profit margin for each respective service rather than a consolidated profit margin. In the prior audit reports, profit was calculated based on the entire company. Since not all services were charged to Medicare, however, the recalculated profit is lower.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART A
for the period October 1, 1984 through September 30, 1985

<u>Subsidiary</u>	<u>HHS Audit Report</u>			<u>BCBSM Recalculated Subsidiary Costs Claimed</u>	<u>Amount Recommended for Financial Adjustment</u>	<u>Reference</u>
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
Diversified Technologies Incorporated	\$ 796,694	\$157,306	\$ 954,000	\$ 835,730	\$138,902	Schedule F-1
H.C. Real Estate Company	248,269	13,066	261,335	393,836	25,993	Schedule F-2
Blue Ribbon, Inc.	<u>11,927</u>	<u>4,119</u>	<u>16,046</u>	<u>8,896</u>	<u>2,617</u>	Schedule F-3
Total	<u>\$1,056,890</u>	<u>\$174,491</u>	<u>\$1,231,381</u>	<u>\$1,238,462</u>	<u>\$167,512</u>	

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART B
for the period October 1, 1984 through September 30, 1985

Subsidiary	HHS Audit Report			BCBSM Recalculated Subsidiary Costs Claimed	Amount Recommended for Financial Adjustment	Reference
	Disclaimed Costs	Profit Recommended for Financial Adjustment	Total			
Diversified Technologies Incorporated	\$1,208,067	\$238,933	\$1,447,000	\$1,625,121	\$242,595	Schedule F-1
H.C. Real Estate Company	529,645	27,876	557,521	867,262	57,239	Schedule F-2
Blue Ribbon, Inc.	224,934	79,945	304,879	18,125	5,267	Schedule F-3
Total	<u>\$1,962,646</u>	<u>\$346,754</u>	<u>\$2,309,400</u>	<u>\$2,510,508</u>	<u>\$305,101</u>	

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF DIVERSIFIED TECHNOLOGIES INCORPORATED RECALCULATED COSTS CLAIMED
AND AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1984 through September 30, 1985

Service	Recalculated Costs Claimed			Amount Recommended For Financial Adjustment			Notes
	Medicare Part A	Medicare Part B	Total	Medicare Part A	Medicare Part B	Total	
Equipment leasing	\$102,907	\$ 115,089	\$217,996	\$ 37,184	\$ 41,573	\$ 78,757	1,2
Information services	165,623	543,407	709,030	19,556	64,155	83,711	1,2
Marketing disaster recovery	39,324	45,756	85,080	8,984	10,456	19,440	1,2
Automated input	255,517	316,921	572,438	40,232	49,901	90,133	1,2
Business assistance	31,866	34,793	66,659	4,290	4,684	8,974	1,2
Records storage	53,955	116,456	170,411	1,365	2,946	4,311	1
Archive records	22,761	47,168	69,929	6,250	12,952	19,202	1
Micrographics	39,552	82,516	122,068	489	1,021	1,510	2
Material and equipment management	25,300	114,815	140,115	4,789	21,732	26,521	1,2
Printing and distribution	98,925	208,200	307,125	15,763	33,175	48,938	1,2
Total	<u>\$835,730</u>	<u>\$1,625,121</u>	<u>\$2,460,851</u>	<u>\$138,902</u>	<u>\$242,595</u>	<u>\$381,497</u>	

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE F-1

for the period October 1, 1984 through September 30, 1985

NOTE 1 - COSTS RECOMMENDED FOR FINANCIAL ADJUSTMENT - \$381,497

The \$381,497 recommended for financial adjustment is comprised of the following:

	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Reference</u>
Profit billed	\$120,175	\$207,806	\$327,981	Note 1a
Ineligible costs	<u>18,727</u>	<u>34,789</u>	<u>53,516</u>	Note 1b
Total	<u>\$138,902</u>	<u>\$242,595</u>	<u>\$381,497</u>	

- a. The \$327,981 recommended for financial adjustment represents profit billed by Diversified Technologies Incorporated (Diversitec) to Blue Cross and Blue Shield of Michigan (BCBSM) for administrative services provided to the Medicare Program. The administrative services provided by Diversitec for which significant costs were charged to the Medicare Program were equipment leasing, information services, marketing disaster recovery, automated input, business assistance, records storage, archive records, material and equipment management, and printing and distribution. Diversitec's job cost system did not permit comparison of actual costs to the amount billed. Therefore, the Diversitec Statement of Operations with Allocations Report was obtained for each responsibility center and a profit margin was calculated, detailed as follows:

<u>Service</u>	<u>Statement of Operations</u>			<u>Profit Margin</u>
	<u>Revenue</u>	<u>Expenses</u>	<u>Net Income</u>	
Equipment leasing	\$2,797,279	\$2,015,004	\$782,275	27.97%
Information services	4,628,783	4,240,974	387,809	8.38%
Marketing disaster recovery	2,599,696	2,119,611	480,085	18.47%
Automated input	2,276,458	1,928,964	347,494	15.26%
Business assistance	5,778,412	5,060,144	718,268	12.43%
Records storage	583,161	568,422	14,739	2.53%
Archive records	216,208	156,840	59,368	27.46%
Material and equipment management	2,354,016	1,909,709	444,307	18.87%
Printing and distribution	2,450,486	2,081,151	369,335	15.07%

According to the Medicare Part A Agreement No. HCFA 84-001-1.25, Article XV, and Medicare Part B Agreement No. HCFA 84-016-2, Article XVIII, "Subcontracting":

- B. It is the policy of the Government to procure property and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate cost to the Government. In order to achieve this objective, competitive proposals shall be utilized to the maximum practical extent.

Because the subsidiaries were wholly-owned by the Auditee and competitive bidding was not applied, the lowest possible cost to Medicare would be the actual costs incurred by the subsidiaries.

Also, Article V in the Auditee's agreement with Diversitec (a wholly-owned subsidiary), Fees and Payment, states:

...all fees and charges for services to be provided by Diversitec pursuant to this Agreement shall be based upon and include only reasonable costs....

In addition, Articles XIII and XV of Medicare Agreement Nos. HCFA 84-001-1.25 and HCFA 84-016-2 state:

- A. It is the intent of this agreement that the Plan, in performing its function under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$327,981 has been recommended for financial adjustment in accordance with Articles XV, XVIII, and XIII of the Medicare Agreements, calculated as follows:

Service	Recalculated Costs Claimed			Profit Margin	Amount Recommended For Financial Adjustment		
	Medicare Part A	Medicare Part B	Total		Medicare Part A	Medicare Part B	Total
	Equipment leasing	\$102,907	\$ 115,089		\$ 217,996	27.97%	\$ 28,783
Information services	165,623	543,407	709,030	8.38%	13,879	45,538	59,417
Marketing disaster recovery	39,324	45,756	85,080	18.47%	7,263	8,451	15,714
Automated input	255,517	316,921	572,438	15.26%	38,992	48,362	87,354
Business assistance	31,866	34,793	66,659	12.43%	3,961	4,325	8,286
Records storage	53,955	116,456	170,411	2.53%	1,365	2,946	4,311
Archive records	22,761	47,168	69,929	27.46%	6,250	12,952	19,202
Micrographics	39,552	82,516	122,068	0%	-	-	-
Material and equipment management	25,300	114,815	140,115	18.87%	4,774	21,666	26,440
Printing and distribution	98,925	208,200	307,125	15.07%	14,908	31,376	46,284
Total	\$835,730	\$1,625,121	\$2,460,851		\$120,175	\$207,806	\$327,981

b. The \$53,516 recommended for financial adjustment represents ineligible costs billed by Diversitec to BCBSM. The Diversitec Statement of Operations with Allocations Reports were reviewed for each Diversitec service provided to the Medicare Program to determine whether ineligible costs were claimed. The following ineligible costs were noted:

Service	Ineligible Costs						Total
	Interest	Entertainment	Advertising-Printed	Special Promotions	Contributions	Bad Debt Expense	
Equipment leasing	\$228,295	\$ -	\$ -	\$ -	\$ -	\$ -	\$228,295
Information services	148,290	7,960	40	2,285	-	-	158,575
Marketing Disaster recovery	37,073	5,802	44,144	16,433	495	10,000	113,947
Automated input	-	3,666	178	7,027	184	-	11,055
Business assistance	-	7,468	1,266	13,398	240	37,500	59,872
Micrographics	-	170	481	7,557	-	-	8,208
Material and equipment management	57	-	842	458	-	-	1,357
Printing and distribution	181	2,731	179	578	-	17,500	21,169
Total	\$413,896	\$27,797	\$47,130	\$47,736	\$919	\$65,000	\$602,478

According to 48 CFR 31.205-1:

(c) Advertising costs...are unallowable.

Also, 48 CFR 31.205-3 states that:

Bad debts...and any directly associated costs such as collection costs, and legal costs are unallowable.

In addition, 48 CFR 31.205-8 states that:

Contributions and donations are unallowable.

Furthermore, 48 CFR 31.205-14 states that:

Costs of amusement, diversion, social activities...are unallowable.

Finally, according to 48 CFR 31.205-20:

Interest on borrowings (however represented), bond discounts, costs of financing and refinancing capital (net worth plus long-term liabilities)...are unallowable...

Advertising and contributions are specifically unallowable in accordance with Paragraph XV of Appendix B to the Medicare Agreement.

Because Diversitec did not maintain cost records, the ineligible costs were allocated to the Medicare Program based on a percentage of costs for services charged to the Medicare Program related to the total Diversitec revenues.

Therefore, \$53,516 has been recommended for financial adjustment in accordance with Appendix B, Paragraph XV and 48 CFR 31.205-1, 31.205-3, 31.205-8, 31.205-14, and 31.205-20, calculated as follows:

Service	Total Ineligible Costs	Diversitec Revenues	Medicare Part A			Medicare Part B			Total Recommended for Financial Adjustment
			Amount Charged	Percent Charged	Allocated Ineligible Costs	Amount Charged	Percent Charged	Allocated Ineligible Costs	
Equipment leasing	\$228,295	\$ 2,797,279	\$102,907	3.68%	\$ 8,401	\$ 115,089	4.11%	\$ 9,383	\$17,784
Information services	158,575	4,628,783	165,623	3.58%	5,677	543,407	11.74%	18,617	24,294
Marketing disaster recovery	113,947	2,599,696	39,324	1.51%	1,721	45,756	1.76%	2,005	3,726
Automated input	11,055	2,276,458	255,517	11.22%	1,240	316,921	13.92%	1,539	2,779
Business assistance	59,872	5,778,412	31,866	.55%	329	34,793	.60%	359	688
Records storage	-	583,161	53,955	-	-	116,456	-	-	-
Archive records	-	216,208	22,761	-	-	47,168	-	-	-
Micrographics	8,208	663,205	39,552	5.96%	489	82,516	12.44%	1,021	1,510
Material and equipment management	1,357	2,354,016	25,300	1.07%	15	114,815	4.88%	66	81
Printing and distribution	21,169	2,450,486	98,925	4.04%	855	208,200	8.50%	1,799	2,654
Total	\$602,478	\$24,347,704	\$835,730		\$18,727	\$1,625,121		\$34,789	\$53,516

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF H.C. REAL ESTATE COMPANY RECALCULATED COSTS CLAIMED AND
AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1984 through September 30, 1985

<u>Service</u>	<u>(Note 1) Recalculated Costs Claimed</u>			<u>Amount Recommended For Financial Adjustment</u>			<u>Notes</u>
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	
	Facility management	<u>\$393,836</u>	<u>\$867,262</u>	<u>\$1,261,098</u>	<u>\$25,993</u>	<u>\$57,239</u>	

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE F-2

for the period October 1, 1984 through September 30, 1985

NOTE 1 - RECALCULATED COSTS CLAIMED

The recalculated Medicare costs claimed for services performed by H.C. Real Estate Company (H.C. Real Estate) in FY 1985 were calculated by averaging the Medicare percentages claimed for FY 1986 and 1987 and applying the average percentage to the revenues for services to affiliates in H.C. Real Estate's 1985 audited financial statements. Blue Cross and Blue Shield of Michigan (BCBSM) was unable to reconstruct the actual costs claimed because the distribution reports were not available for 1985. The recalculated costs claimed were calculated as follows:

		<u>Medicare Part A</u>	<u>Medicare Part B</u>
Recalculated costs charged to Medicare:			
1986	\$665,880		\$1,165,137
1987	<u>661,330</u>		<u>1,753,181</u>
		\$1,327,210	\$2,918,318
Total H.C. Real Estate affiliated revenues:			
1986	\$21,490,191		
1987	<u>24,718,726</u>		
		<u>46,208,917</u>	<u>46,208,917</u>
Average percent charged to Medicare		2.87%	6.32%
Affiliated revenue for 1985		<u>13,722,507</u>	<u>13,722,507</u>
Recalculated costs claimed		<u>\$ 393,836</u>	<u>\$ 867,262</u>

NOTE 2 - PROFIT

The \$83,232 recommended for financial adjustment represents profit billed by H.C. Real Estate to BCBSM for administration of the Medicare Program. H.C. Real Estate's job cost system did not permit comparison of actual costs to the amount billed. In addition, a profit margin by service could not be calculated because this information was not available. Therefore, the audited financial statements were obtained and a profit margin was calculated, detailed as follows:

NOTE 2 - PROFIT (continued)

H.C. Real Estate 1985 Audited Financial Statements

<u>Revenues</u>	<u>Expenses</u>	<u>Net Income</u>	<u>Profit Margin</u>
<u>\$18,120,224</u>	<u>\$16,924,771</u>	<u>\$1,195,453</u>	<u>6.60%</u>

According to the Medicare Part A Agreement No. HCFA 84-001-1.25, Article XV, and Medicare Part B Agreement No. HCFA 84-016-2, Article XVIII, "Subcontracting":

- B. It is the policy of the Government to procure property and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate cost to the Government. In order to achieve this objective, competitive proposals shall be utilized to the maximum practical extent.

Because the subsidiaries were wholly-owned by the Auditee and competitive bidding was not applied, the lowest possible cost to Medicare would be the actual costs incurred by the subsidiaries.

In addition, Articles XIII and XV of Medicare Agreement Nos. HCFA 84-001-1.25 and HCFA 84-016-2 state:

- A. It is the intent of this agreement that the Plan, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$83,232 has been recommended for financial adjustment in accordance with Articles XV, XVIII, and XIII of the Medicare Agreements, calculated as follows:

<u>Recalculated Costs Claimed</u>			<u>Profit Margin</u>	<u>Amount Recommended For Financial Adjustment</u>		
<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>		<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>
<u>\$393,836</u>	<u>\$867,262</u>	<u>\$1,261,098</u>	<u>6.60%</u>	<u>\$25,993</u>	<u>\$57,239</u>	<u>\$83,232</u>

NOTE 3 - INELIGIBLE COSTS

We were unable to determine if ineligible costs were billed by H.C. Real Estate in FY 1985. BCBSM was unable to provide H.C. Real Estate's expense general ledgers for 1985. In addition, the H.C. Real Estate audited financial statements for 1985 did not provide a breakdown of the expenses. Therefore, we were unable to perform a review to determine if ineligible costs were billed.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF BLUE RIBBON, INC. RECALCULATED COSTS CLAIMED AND
AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1984 through September 30, 1985

<u>Service</u>	<u>(Note 1) Recalculated Costs Claimed</u>			<u>Amount Recommended For Financial Adjustment</u>			<u>Notes</u>
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	
	Various services	<u>\$8,896</u>	<u>\$18,125</u>	<u>\$27,021</u>	<u>\$2,617</u>	<u>\$5,267</u>	

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE F-3

for the period October 1, 1984 through September 30, 1985

NOTE 1 - RECALCULATED COSTS CLAIMED

Our review disclosed that Medicare was charged a portion of the Blue Ribbon, Inc. (Blue Ribbon) costs that were charged to Cost Center No. 35410. Therefore, the activity posted to Cost Center No. 35410 was analyzed to determine the Blue Ribbon costs charged to Medicare. Detail of the recalculated costs claimed is as follows:

	<u>Blue Ribbon Costs Charged to CC 35410</u>	<u>Medicare Allocation Rates</u>		<u>Allocated Costs</u>	
		<u>Part A</u>	<u>Part B</u>	<u>Part A</u>	<u>Part B</u>
October 1984	\$ 10,442	6.14%	12.73%	\$ 641	\$ 1,329
November 1984	19,708	6.20%	13.10%	1,222	2,582
December 1984	10,442	5.82%	13.57%	608	1,417
January 1985	(20,883)	5.55%	12.42%	(1,159)	(2,594)
February 1985	-	5.35%	11.82%	-	-
March 1985	-	5.51%	10.34%	-	-
April 1985	-	5.48%	10.95%	-	-
May 1985	73,092	5.71%	11.50%	4,174	8,406
June 1985	26,792	5.57%	11.53%	1,492	3,089
July 1985	12,196	5.23%	11.59%	638	1,414
August 1985	13,018	6.02%	11.48%	784	1,494
September 1985	<u>8,638</u>	5.74%	11.44%	<u>496</u>	<u>988</u>
Total	<u>\$153,445</u>			<u>\$8,896</u>	<u>\$18,125</u>

NOTE 2 - PROFIT

The \$7,884 recommended for financial adjustment represents profit billed by Blue Ribbon to Blue Cross and Blue Shield of Michigan (BCBSM). Blue Ribbon's job cost system did not permit comparison of actual costs to the amount billed. In addition, a profit margin by service could not be calculated because the information was not available. Therefore, the audited financial statements were obtained and a profit margin was calculated, detailed as follows:

NOTE 2 - PROFIT (continued)

Blue Ribbon 1985 and 1984 Audited Financial Statements

	<u>Revenues</u>	<u>Expenses</u>	<u>Net Income</u>	<u>Profit Margin</u>
1984	<u>\$2,109,387</u>	<u>\$1,835,487</u>	<u>\$ 273,900</u>	<u>12.98%</u>
1985	<u>\$3,396,822</u>	<u>\$2,182,261</u>	<u>\$1,214,561</u>	<u>35.76%</u>

* The net income before taxes was used because income taxes are unallowable in accordance with 48 CFR 31.205-41.

According to Medicare Part A Agreement No. HCFA 84-001-1.25, Article XV, and Medicare Part B Agreement No. HCFA 84-016-2, Article XVIII, "Subcontracting":

B. It is the policy of the Government to procure property and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate cost to the Government. In order to achieve this objective, competitive proposals shall be utilized to the maximum practical extent.

Because the subsidiaries were wholly-owned by the Auditee and competitive bidding was not applied, the lowest possible cost to Medicare would be the actual costs incurred by the subsidiaries.

In addition, Articles XIII and XV of Medicare Agreement Nos. HCFA 84-001-1.25 and HCFA 84-016-2 state:

A. It is the intent of this agreement that the Plan, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$7,884 has been recommended for financial adjustment in accordance with Medicare Agreement Nos. HCFA 84-001-1.25 and HCFA 84-016-2, calculated as follows:

	<u>Recalculated Costs Claimed</u>			<u>Profit Margin</u>	<u>Amount Recommended For Financial Adjustment</u>		
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>		<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>
1984	<u>\$2,471</u>	<u>\$ 5,328</u>	<u>\$ 7,799</u>	12.98%	<u>\$ 321</u>	<u>\$ 692</u>	<u>\$1,013</u>
1985	<u>6,425</u>	<u>12,797</u>	<u>19,222</u>	35.76%	<u>2,296</u>	<u>4,575</u>	<u>6,871</u>
Total	<u>\$8,896</u>	<u>\$18,125</u>	<u>\$27,021</u>		<u>\$2,617</u>	<u>\$5,267</u>	<u>\$7,884</u>

NOTE 3 - INELIGIBLE COSTS

We were unable to perform a review to determine if ineligible costs were billed by Blue Ribbon in FY 1985. BCBSM was unable to provide Blue Ribbon expense general ledgers for 1985. In addition, the Blue Ribbon audited financial statements for 1985 did not provide a breakdown of the expenses. Therefore, we were unable to perform a review to determine if ineligible costs were billed.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SUMMARY OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1985 through September 30, 1986

	HHS Audit Report			BCBSM Recalculated Subsidiary Costs Claimed	Amount Recommended for Financial Adjustment (Note 1)	Reference
	Disclaimed Costs	Profit Recommended for Financial Adjustment	Total			
Medicare						
Part A	\$1,542,756	\$118,602	\$1,661,358	\$1,313,913	\$ 89,187	Exhibit G-1
Part B	<u>3,140,149</u>	<u>241,405</u>	<u>3,381,554</u>	<u>2,071,856</u>	<u>135,223</u>	Exhibit G-2
	<u>\$4,682,905</u>	<u>\$360,007</u>	<u>\$5,042,912</u>	<u>\$3,385,769</u>	<u>\$224,410</u>	

Note 1: The amount recommended for financial adjustment in this report differs from the amount recommended for financial adjustment in the HHS audit report because 1) the subsidiary costs claimed have been recalculated by BCBSM (according to BCBSM, these costs are the actual costs claimed based on their job cost accounting records); and 2) for Diversitec, we have calculated the profit margin for each respective service rather than a consolidated profit margin. In the prior audit reports, costs were questioned on a companywide basis. However, because all services were not billed to Medicare, a smaller amount of profit results.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART A
for the period October 1, 1985 through September 30, 1986

Subsidiary	HHS Audit Report			BCBSM Recalculated Subsidiary Costs Claimed	Amount Recommended for Financial Adjustment	Reference
	Disclaimed Costs	Profit Recommended for Financial Adjustment	Total			
Diversified Technologies Incorporated	\$ 745,287	\$ 34,397	\$ 779,684	\$ 500,162	\$60,921	Schedule G-1
H.C. Real Estate Company	644,080	13,154	657,234	665,880	2,863	Schedule G-2
Tower Management Company	88,650	8,194	96,844	132,605	19,297	Schedule G-3
Blue Ribbon, Inc.	64,739	62,857	127,596	15,266	6,106	Schedule G-4
Total	<u>\$1,542,756</u>	<u>\$118,602</u>	<u>\$1,661,358</u>	<u>\$1,313,913</u>	<u>\$89,187</u>	

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

**SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT**

**MEDICARE PART B
for the period October 1, 1985 through September 30, 1986**

<u>Subsidiary</u>	<u>HHS Audit Report</u>			<u>BCBSM Recalculated Subsidiary Costs Claimed</u>	<u>Amount Recommended for Financial Adjustment</u>	<u>Reference</u>
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
Diversified Technologies Incorporated	\$1,516,968	\$ 70,013	\$1,586,981	\$ 726,145	\$ 95,866	schedule G-1
H.C. Real Estate Company	1,310,972	26,773	1,337,745	1,165,137	5,010	schedule G-2
Tower Management Company	180,440	16,678	197,118	148,921	21,690	schedule G-3
Blue Ribbon, Inc.	131,769	127,941	259,710	31,653	12,657	schedule G-4
Total	<u>\$3,140,149</u>	<u>\$241,405</u>	<u>\$3,381,554</u>	<u>\$2,071,856</u>	<u>\$135,223</u>	

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF DIVERSIFIED TECHNOLOGIES INCORPORATED RECALCULATED
COSTS CLAIMED AND AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1985 through September 30, 1986

<u>Service</u>	<u>Recalculated Costs Claimed</u>			<u>Amount Recommended For Financial Adjustment</u>			<u>Note</u>
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	
Information services	\$ 39,477	\$ 20,283	\$ 59,760	\$ 2,551	\$ 1,310	\$ 3,861	1
Disaster recovery	36,036	28,620	64,656	786	624	1,410	1
Automated input	301,589	344,686	646,275	36,287	41,473	77,760	1
Records storage	2,892	21,984	24,876	20	152	172	1
Material and equipment management	37,416	147,192	184,608	5,254	20,671	25,925	1
Printing	82,752	163,380	246,132	16,023	31,636	47,659	1
Total	<u>\$500,162</u>	<u>\$726,145</u>	<u>\$1,226,307</u>	<u>\$60,921</u>	<u>\$95,866</u>	<u>\$156,787</u>	

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE G-1

for the period October 1, 1985 through September 30, 1986

NOTE 1 - COSTS RECOMMENDED FOR FINANCIAL ADJUSTMENT - \$156,787

The \$156,787 recommended for financial adjustment is comprised of the following:

	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Reference</u>
Profit billed	\$59,265	\$93,630	\$152,895	Note 1a
Ineligible costs	<u>1,656</u>	<u>2,236</u>	<u>3,892</u>	Note 1b
Total	<u>\$60,921</u>	<u>\$95,866</u>	<u>\$156,787</u>	

- a. The \$152,895 recommended for financial adjustment represents profit billed by Diversified Technologies Incorporated (Diversitec) to Blue Cross and Blue Shield of Michigan (BCBSM). The administrative services provided by Diversitec for which significant costs were charged to the Medicare Program were information services, marketing disaster recovery, automated input, records storage, material and equipment management, and printing. Diversitec's job cost system did not permit comparison of actual costs to the amount billed. Therefore, the Diversitec Statement of Operations with Allocations Reports were obtained and a profit margin was calculated, detailed as follows:

<u>Service</u>	<u>Statement of Operations</u>			<u>Profit Margin</u>
	<u>Revenue</u>	<u>Expenses</u>	<u>Net Income</u>	
Information services	\$3,883,090	\$3,634,105	\$248,985	6.41%
Marketing disaster recovery	2,457,138	2,450,725	6,413	.26%
Automated input	2,068,706	1,824,190	244,516	11.82%
Material and equipment management	3,188,035	2,750,412	437,623	13.73%
Printing	3,383,469	2,735,099	648,370	19.16%

According to the Medicare Part A Agreement No. HCFA 84-001-1.25, Article XV, and Medicare Part B Agreement No. HCFA 84-016-2, Article XVIII, "Subcontracting":

- B. It is the policy of the Government to procure property and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate cost to the Government. In order to achieve this objective, competitive proposals shall be utilized to the maximum practical extent.

Because the subsidiaries were wholly-owned by the Auditee and competitive bidding was not applied, the lowest possible cost to Medicare would be the actual costs incurred by the subsidiaries.

Also, Article V in the Auditee's agreement with Diversitec (a wholly-owned subsidiary), Fees and Payment, states:

...all fees and charges for services to be provided by Diversitec pursuant to this Agreement shall be based upon and include only reasonable costs....

In addition, Articles XIII and XV of Medicare Agreement Nos. HCFA 84-001-1.25 and HCFA 84-016-2 state:

A. It is the intent of this agreement that the Plan, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$152,895 has been recommended for financial adjustment in accordance with Articles XV, XVIII, and XIII of the Medicare Agreements, calculated as follows:

Service	Recalculated Costs Claimed			Profit Margin	Amount Recommended For Financial Adjustment		
	Medicare Part A	Medicare Part B	Total		Medicare Part A	Medicare Part B	Total
	Information services	\$ 39,477	\$ 20,283		\$ 59,760	6.41%	\$ 2,531
Marketing disaster recovery	36,036	28,620	64,656	.26%	94	75	169
Automated input	301,589	344,686	646,275	11.82%	35,648	40,742	76,390
Records storage	2,892	21,984	24,876	0%	-	-	-
Material and equipment management	37,416	147,192	184,608	13.73%	5,137	20,209	25,346
Printing	<u>82,752</u>	<u>163,380</u>	<u>246,132</u>	19.16%	<u>15,855</u>	<u>31,304</u>	<u>47,159</u>
Total	<u>\$500,162</u>	<u>\$726,145</u>	<u>\$1,226,307</u>		<u>\$59,265</u>	<u>\$93,630</u>	<u>\$152,895</u>

b. The \$3,892 recommended for financial adjustment represents ineligible costs billed by Diversitec to BCBSM. Diversitec's Statement of Operations with Allocations Reports were reviewed for each Diversitec service provided to the Medicare Program to determine whether ineligible costs were claimed. The following ineligible costs were noted:

Ineligible costs:	Information Services	Disaster Recovery	Automated Input	Record Storage	Material and Equipment Management	Printing
Entertainment	\$ 73	\$ 3,251	\$ 588	\$ 12	\$ -	\$1,673
Special promotions	1,869	5,444	3,798	4,048	-	200
Interest	-	144	-	-	-	-
Advertising-printed	-	33,317	-	-	-	-
Bad debt expense	-	5,000	-	-	10,000	5,000
Total	<u>\$1,942</u>	<u>\$47,156</u>	<u>\$4,386</u>	<u>\$4,060</u>	<u>\$10,000</u>	<u>\$6,873</u>

According to 48 CFR 31.205-1:

(c) Advertising costs...are unallowable.

Also, 48 CFR 31.205-3 states that:

Bad debts, including actual or estimated losses arising from uncollectible accounts receivable due from customers and other claims...are unallowable.

In addition, 48 CFR 31.205-14 states that:

Costs of amusement, diversion, social activities...are unallowable.

Finally, according to 48 CFR 31.205-20:

Interest on borrowing (however represented), bond discounts, costs of financing and refinancing capital (net worth plus long-term liabilities)...are unallowable...

In addition, advertising and contributions are specifically unallowable in accordance with Paragraph XV of Appendix B to the Medicare Agreement.

Because Diversitec did not maintain cost records, the ineligible costs were allocated to the Medicare Program based on a percentage of costs charged to the Medicare Program to Diversitec revenues.

Therefore, \$3,892 has been recommended for financial adjustment in accordance with Appendix B, Paragraph XV and 48 CFR 31.205-1, 31.205-3, 31.205-14, and 31.205-20, calculated as follows:

Service	Total Ineligible Costs	Diversitec Revenues	Medicare Part A			Medicare Part B			Total Recommended for Financial Adjustment
			Amount Charged	Percent Charged	Allocated Ineligible Costs	Amount Charged	Percent Charged	Allocated Ineligible Costs	
Information services	\$ 1,942	\$ 3,883,090	\$ 39,477	1.02%	\$ 20	\$ 20,283	0.52%	\$ 10	\$ 30
Marketing disaster recovery	47,156	2,457,138	36,036	1.47%	692	28,620	1.16%	549	1,241
Automated input	4,386	2,068,706	301,589	14.58%	639	344,686	16.66%	731	1,370
Records storage	4,060	586,607	2,892	0.49%	20	21,984	3.75%	152	172
Material and equipment management	10,000	3,188,035	37,416	1.17%	117	147,192	4.62%	462	579
Printing	<u>6,873</u>	<u>3,383,469</u>	<u>82,752</u>	2.45%	<u>168</u>	<u>163,380</u>	4.83%	<u>332</u>	<u>500</u>
Total	<u>\$74,417</u>	<u>\$15,567,045</u>	<u>\$500,162</u>		<u>\$1,656</u>	<u>\$726,145</u>		<u>\$2,236</u>	<u>\$3,892</u>

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF H.C. REAL ESTATE COMPANY RECALCULATED COSTS CLAIMED AND
AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1985 through September 30, 1986

<u>Service</u>	<u>Recalculated Costs Claimed</u>			<u>Amount Recommended For Financial Adjustment</u>			<u>Notes</u>
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	
Facility management	<u>\$665,880</u>	<u>\$1,165,137</u>	<u>\$1,831,017</u>	<u>\$2,863</u>	<u>\$5,010</u>	<u>\$7,873</u>	1,2

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE G-2

for the period October 1, 1985 through September 30, 1986

NOTE 1 - PROFIT

The \$7,873 recommended for financial adjustment represents profit billed by H.C. Real Estate Company (H.C. Real Estate) to Blue Cross and Blue Shield of Michigan (BCBSM). H.C. Real Estate's job cost system did not permit comparison of actual costs to the amount billed. In addition, a profit margin by service could not be calculated because this information was not available. Therefore, the audited financial statements were obtained and a profit margin was calculated, detailed as follows:

<u>H.C. Real Estate 1986 Audited Financial Statements</u>			
<u>Revenues</u>	<u>Expenses</u>	<u>Net Income</u>	<u>Profit Margin</u>
<u>\$29,096,866</u>	<u>\$28,971,711</u>	<u>\$125,155</u>	<u>.43%</u>

According to the Medicare Part A Agreement No. HCFA 84-001-1.25, Article XV, and Medicare Part B Agreement No. HCFA 84-016-2, Article XVIII, "Subcontracting":

- B. It is the policy of the Government to procure property and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate cost to the Government. In order to achieve this objective, competitive proposals shall be utilized to the maximum practical extent.

Because the subsidiaries were wholly-owned by the Auditee and competitive bidding was not applied, the lowest possible cost to Medicare would be the actual costs incurred by the subsidiaries.

Therefore, \$7,873 has been recommended for financial adjustment in accordance with Articles XV and XVIII of the Medicare agreements, calculated as follows:

<u>Recalculated Costs Claimed</u>			<u>Profit Margin</u>	<u>Amount Recommended For Financial Adjustment</u>		
<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>		<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>
<u>\$665,880</u>	<u>\$1,165,137</u>	<u>\$1,831,017</u>	<u>0.43%</u>	<u>\$2,863</u>	<u>\$5,010</u>	<u>\$7,873</u>

NOTE 2 - INELIGIBLE COSTS

We were unable to perform a review to determine if ineligible costs were billed by H.C. Real Estate in FY 1986. BCBSM was unable to provide H.C. Real Estate expense general ledgers for 1986. In addition, the H.C. Real Estate audited financial statements for 1986 did not provide a breakdown of the expenses. Therefore, the costs claimed may include ineligible costs.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN

DETROIT, MICHIGAN

DETAIL OF TOWER MANAGEMENT COMPANY RECALCULATED COSTS CLAIMED AND
AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1985 through September 30, 1986

Service	Recalculated Costs Claimed			Amount Recommended For Financial Adjustment			Notes
	Medicare Part A	Medicare Part B	Total	Medicare Part A	Medicare Part B	Total	
Disk storage	\$101,243	\$ 96,827	\$198,070	\$14,735	\$14,111	\$28,846	1
Cash management fees	19,232	35,051	54,283	2,793	5,097	7,890	1
Direct finance lease	<u>12,130</u>	<u>17,043</u>	<u>29,173</u>	<u>1,769</u>	<u>2,482</u>	<u>4,251</u>	1
Total	<u>\$132,605</u>	<u>\$148,921</u>	<u>\$281,526</u>	<u>\$19,297</u>	<u>\$21,690</u>	<u>\$40,987</u>	

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE G-3

for the period October 1, 1985 through September 30, 1986

NOTE 1 - COSTS RECOMMENDED FOR FINANCIAL ADJUSTMENT - \$40,987

The \$40,987 recommended for financial adjustment is comprised of the following:

	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Reference</u>
Profit billed	\$12,451	\$13,983	\$26,434	Note 1a
Ineligible costs	<u>6,846</u>	<u>7,707</u>	<u>14,553</u>	Note 1b
Total	<u>\$19,297</u>	<u>\$21,690</u>	<u>\$40,987</u>	

- a. The \$26,434 recommended for financial adjustment represents profit billed by Tower Management Company (Tower Management) to Blue Cross and Blue Shield of Michigan (BCBSM). Tower Management's job cost system did not permit comparison of actual costs to the amount billed. In addition, a profit margin by service could not be calculated because the information was not available. Therefore, the audited financial statements were obtained and a profit margin as a percentage of total revenues was calculated, detailed as follows:

<u>Tower Management 1986 Audited Financial Statements</u>		
<u>Revenues</u>	<u>Net Income</u>	<u>Profit Margin</u>
<u>\$4,058,576</u>	<u>\$381,091</u>	<u>9.39%</u>

According to the Medicare Part A Agreement No. HCFA 84-001-1.25, Article XV, and Medicare Part B Agreement No. HCFA 84-016-2, Article XVIII, "Subcontracting":

- B. It is the policy of the Government to procure property and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate cost to the Government. In order to achieve this objective, competitive proposals shall be utilized to the maximum practical extent.

Because the subsidiaries were wholly-owned by the Auditee and competitive bidding was not applied, the lowest possible cost to Medicare would be the actual costs incurred by the subsidiaries.

In addition, Articles XIII and XV for Medicare Agreement Nos. HCFA 84-001-1.25 and HCFA 84-016-2 state:

- A. It is the intent of this agreement that the Plan, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$26,434 has been recommended for financial adjustment in accordance with Articles XV, XVIII, and XIII of the Medicare Agreements, calculated as follows:

Service	Recalculated Costs Claimed			Profit Margin	Amount Recommended For Financial Adjustment		
	Medicare Part A	Medicare Part B	Total		Medicare Part A	Medicare Part B	Total
Disk storage	\$101,243	\$ 96,827	\$198,070	9.39%	\$ 9,506	\$ 9,092	\$18,598
Cash management fees	19,232	35,051	54,283	9.39%	1,806	3,291	5,097
Direct finance lease	<u>12,130</u>	<u>17,043</u>	<u>29,173</u>	9.39%	<u>1,139</u>	<u>1,600</u>	<u>2,739</u>
Total	<u>\$132,605</u>	<u>\$148,921</u>	<u>\$281,526</u>		<u>\$12,451</u>	<u>\$13,983</u>	<u>\$26,434</u>

- b. The \$14,553 recommended for financial adjustment represents ineligible costs billed by Tower Management to BCBSM. BCBSM was unable to provide Tower Management's expense general ledgers for 1986. Therefore, the audited financial statements were obtained to determine whether ineligible costs were claimed. The following ineligible costs were noted:

Ineligible costs:

Interest \$210,000

According to 48 CFR 31.205-20:

Interest and other financial costs:

Interest on borrowing (however represented), bond discounts, costs of financing and refinancing capital (net worth plus long-term liabilities) ... are unallowable...

Because Tower Management did not maintain cost records, the ineligible costs were allocated to the Medicare Program based on a percentage of costs charged to the Medicare Program relating to Tower Management's total revenues.

Therefore, \$14,553 has been recommended for financial adjustment in accordance with 48 CFR 31.205-20, calculated as follows:

<u>Service</u>	<u>Total Ineligible Costs</u>	<u>Tower Revenues</u>	<u>Medicare Part A</u>		<u>Medicare Part B</u>		<u>Total Recommended for Financial Adjustment</u>		
			<u>Amount Charged</u>	<u>Percent Charged</u>	<u>Allocated Ineligible Costs</u>	<u>Amount Charged</u>		<u>Percent Charged</u>	<u>Allocated Ineligible Costs</u>
Disk storage	\$210,000	\$4,058,576	\$101,243	2.49%	\$5,229	\$ 96,827	2.39%	\$5,019	\$10,248
Cash management fees	210,000	4,058,576	19,232	0.47%	987	35,051	0.86%	1,806	2,793
Direct finance lease	210,000	4,058,576	<u>12,130</u>	0.30%	<u>630</u>	<u>17,043</u>	0.42%	<u>882</u>	<u>1,512</u>
Total			<u>\$132,605</u>		<u>\$6,846</u>	<u>\$148,921</u>		<u>\$7,707</u>	<u>\$14,553</u>

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF BLUE RIBBON, INC. RECALCULATED COSTS CLAIMED AND
AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1985 through September 30, 1986

<u>Service</u>	<u>(Note 1)</u> <u>Recalculated Costs Claimed</u>			<u>Amount Recommended</u> <u>For Financial Adjustment</u>			<u>Notes</u>
	<u>Medicare</u>	<u>Medicare</u>	<u>Total</u>	<u>Medicare</u>	<u>Medicare</u>	<u>Total</u>	
	<u>Part A</u>	<u>Part B</u>		<u>Part A</u>	<u>Part B</u>		
Various services	<u>\$15,266</u>	<u>\$31,653</u>	<u>\$46,919</u>	<u>\$6,106</u>	<u>\$12,657</u>	<u>\$18,763</u>	2,3

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE G-4

for the period October 1, 1985 through September 30, 1986

NOTE 1 - RECALCULATED COSTS CLAIMED

Medicare was charged a portion of the Blue Ribbon, Inc. (Blue Ribbon) costs that were charged to Cost Center No. 35410. Therefore, the activity posted to Cost Center No. 35410 was analyzed to determine the Blue Ribbon costs charged to Medicare. Detail of the recalculated costs claimed is as follows:

	Blue Ribbon Costs Charged to CC 35410	Medicare Allocation Rates		Allocated Costs	
		Part A	Part B	Part A	Part B
October 1985	\$ 2,592	5.81%	11.57%	\$ 151	\$ 300
November 1985	13,018	5.32%	11.41%	693	1,485
December 1985	1,372	5.13%	10.61%	70	146
January 1986	31,175	5.41%	10.94%	1,687	3,411
February 1986	9,497	4.83%	10.53%	459	1,000
March 1986	27,716	4.99%	10.39%	1,383	2,880
April 1986	29,840	6.12%	9.40%	1,826	2,805
May 1986	33,841	4.15%	11.23%	1,404	3,800
June 1986	27,368	5.17%	7.81%	1,415	2,137
July 1986	52,368	3.92%	9.47%	2,053	4,959
August 1986	53,366	4.91%	10.09%	2,620	5,385
September 1986	<u>33,895</u>	4.44%	9.87%	<u>1,505</u>	<u>3,345</u>
Total	<u>\$316,048</u>			<u>\$15,266</u>	<u>\$31,653</u>

NOTE 2 - PROFIT

The \$18,763 recommended for financial adjustment represents profit billed by Blue Ribbon to Blue Cross and Blue Shield of Michigan (BCBSM). Blue Ribbon's job cost system did not permit comparison of actual costs to the amount billed. In addition, a profit margin by service could not be calculated because this information was not available. Therefore, the audited financial statements were obtained and a profit margin based on total revenues was calculated, detailed as follows:

NOTE 2 - PROFIT (continued)

Blue Ribbon 1985 and 1986 Audited Financial Statements

	<u>Revenues</u>	<u>Net Income*</u>	<u>Profit Margin</u>
1985	<u>\$3,396,822</u>	<u>\$1,214,561</u>	<u>35.76%</u>
1986	<u>\$5,959,401</u>	<u>\$2,399,359</u>	<u>40.26%</u>

* The net income before taxes was used because income taxes are unallowable in accordance with 48 CFR 31.205-41.

According to Medicare Part A Agreement No. HCFA 84-001-1.25, Article XV, and Medicare Part B Agreement No. HCFA 84-016-2, Article XVIII, "Subcontracting":

- B. It is the policy of the Government to procure property and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate cost to the Government. In order to achieve this objective, competitive proposals shall be utilized to the maximum practical extent.

Because the subsidiaries were wholly-owned by the Auditee and competitive bidding was not applied, the lowest possible cost to Medicare would be the actual costs incurred by the subsidiaries.

In addition, Articles XIII and XV of Medicare Agreement Nos. HCFA 84-001-1.25 and HCFA 84-016-2 state:

- A. It is the intent of this agreement that the Plan, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$18,763 has been recommended for financial adjustment in accordance with Articles XV and XVIII of the Medicare Agreements, calculated as follows:

	<u>Recalculated Costs Claimed</u>			<u>Profit Margin</u>	<u>Amount Recommended For Financial Adjustment</u>		
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>		<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>
1985	\$ 914	\$ 1,931	\$ 2,845	35.76%	\$ 327	\$ 690	\$ 1,017
1986	<u>14,352</u>	<u>29,722</u>	<u>44,074</u>	40.26%	<u>5,779</u>	<u>11,967</u>	<u>17,746</u>
Total	<u>\$15,266</u>	<u>\$31,653</u>	<u>\$46,919</u>		<u>\$6,106</u>	<u>\$12,657</u>	<u>\$18,763</u>

NOTE 3 - INELIGIBLE COSTS

We were unable to perform a review to determine if ineligible costs were billed by Blue Ribbon in FY 1986. BCBSM was unable to provide Blue Ribbon expense general ledgers for 1986. In addition, the Blue Ribbon audited financial statements for 1986 did not provide a breakdown of the expenses. Therefore, we were unable to perform a review to determine if ineligible costs were billed.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SUMMARY OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1986 through September 30, 1987

	<u>HHS Audit Report</u>			<u>BCBSM Recalculated Subsidiary Costs Claimed</u>	<u>Amount Recommended for Financial Adjustment (Note 1)</u>	<u>Reference</u>
	<u>Disclaimed Costs</u>	<u>Profit Recommended for Financial Adjustment</u>	<u>Total</u>			
<u>Medicare</u>						
Part A	\$1,972,702	\$ 48,233	\$2,020,935	\$1,286,956	\$111,489	-Exhibit H-1
Part B	<u>3,868,917</u>	<u>107,051</u>	<u>3,975,968</u>	<u>2,929,743</u>	<u>248,594</u>	Exhibit H-2
	<u>\$5,841,619</u>	<u>\$155,284</u>	<u>\$5,996,903</u>	<u>\$4,216,699</u>	<u>\$360,083</u>	

Note 1: The amount recommended for financial adjustment in this report differs from the amount recommended for financial adjustment in the HHS audit report because 1) the subsidiary costs claimed have been recalculated by BCBSM (according to BCBSM, these costs are the actual costs claimed based on their job cost accounting records); and 2) for Diversitec, we have calculated the profit margin for each respective service rather than a consolidated profit margin. In the prior audit reports, profit was calculated on a companywide basis. However, since not all services were billed to Medicare, the profit billed to Medicare would be less than that shown in the prior audit reports.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART A
for the period October 1, 1986 through September 30, 1987

Subsidiary	HHS Audit Report			BCBSM Recalculated Subsidiary Costs Claimed	Amount Recommended for Financial Adjustment	Reference
	Disclaimed Costs	Profit Recommended for Financial Adjustment	Total			
Diversified Technologies Incorporated	\$ 962,270	\$ -	\$ 962,270	\$ 573,864	\$ 61,347	Schedule H-1
H.C. Real Estate Company	875,092	23,676	898,768	661,330	41,730	Schedule H-2
Tower Management Company	61,780	8,070	69,850	51,762	8,412	Schedule H-3
Blue Ribbon, Inc.	<u>73,560</u>	<u>16,487</u>	<u>90,047</u>	-	-	
Total	<u>\$1,972,702</u>	<u>\$48,233</u>	<u>\$2,020,935</u>	<u>\$1,286,956</u>	<u>\$111,489</u>	

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

SCHEDULE OF HHS AUDIT REPORT DISCLAIMED COSTS, BCBSM RECALCULATED
SUBSIDIARY COSTS CLAIMED, AND AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT

MEDICARE PART B
for the period October 1, 1986 through September 30, 1987

Subsidiary	HHS Audit Report			BCBSM Recalculated Subsidiary Costs Claimed	Amount Recommended for Financial Adjustment	Reference
	Disclaimed Costs	Profit Recommended for Financial Adjustment	Total			
Diversified Technologies Incorporated	\$1,893,161	\$ -	\$1,893,161	\$ 987,745	\$107,314	schedule H-1
H.C. Real Estate Company	1,715,679	52,549	1,768,228	1,753,181	110,626	schedule H-2
Tower Management Company	119,512	17,910	137,422	188,817	30,654	schedule H-3
Blue Ribbon, Inc.	<u>140,565</u>	<u>36,592</u>	<u>177,157</u>	<u>-</u>	<u>-</u>	
Total	<u>\$3,868,917</u>	<u>\$107,051</u>	<u>\$3,975,968</u>	<u>\$2,929,743</u>	<u>\$248,594</u>	

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF DIVERSIFIED TECHNOLOGIES INCORPORATED RECALCULATED COSTS CLAIMED
AND AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1986 through September 30, 1987

Service	Recalculated Costs Claimed			Amount Recommended For Financial Adjustment			Notes
	Medicare Part A	Medicare Part B	Total	Medicare Part A	Medicare Part B	Total	
Disaster recovery	\$ 12,374	\$ 51,754	\$ 64,128	\$ 1,708	\$ 7,146	\$ 8,854	1
Information Services	28,945	18,439	47,384	-	-	-	
Automated input	479,966	487,126	967,092	53,883	54,687	108,570	1
Records storage	4,236	67,032	71,268	29	463	492	1
Material and equipment management	13,183	82,438	95,621	426	2,663	3,089	1
Printing	<u>35,160</u>	<u>280,956</u>	<u>316,116</u>	<u>5,301</u>	<u>42,355</u>	<u>47,656</u>	1
Total	<u>\$573,864</u>	<u>\$987,745</u>	<u>\$1,561,609</u>	<u>\$61,347</u>	<u>\$107,314</u>	<u>\$168,661</u>	

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE H-1

for the period October 1, 1986 through September 30, 1987

NOTE 1 - COSTS RECOMMENDED FOR FINANCIAL ADJUSTMENT - \$168,661

The \$168,661 recommended for financial adjustment is comprised of the following:

	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Reference</u>
Profit billed	\$59,177	\$103,688	\$162,865	Note 1a
Ineligible costs	<u>2,170</u>	<u>3,626</u>	<u>5,796</u>	Note 1b
Total	<u>\$61,347</u>	<u>\$107,314</u>	<u>\$168,661</u>	-

- a. The \$162,865 recommended for financial adjustment represents profit billed by Diversified Technologies Incorporated (Diversitec) to Blue Cross and Blue Shield of Michigan (BCBSM). The administrative services provided by Diversitec for which significant costs were charged to the Medicare Program were information services, disaster recovery, automated input, records storage, material and equipment management, and printing. Diversitec's job cost system did not permit comparison of actual costs to the amount billed. Therefore, the Diversitec Statement of Operations with Allocations Reports for FY 1987 were obtained and a profit margin was calculated, detailed as follows:

<u>Statement of Operations</u>				
<u>Service</u>	<u>Revenue</u>	<u>Expenses</u>	<u>Net Income</u>	<u>Profit Margin</u>
Disaster recovery	\$2,628,982	2,303,416	325,566	12.38%
Automated input	2,714,178	2,420,135	294,043	10.83%
Material and equipment management	2,914,220	2,820,126	94,094	3.23%
Printing	2,988,679	2,543,283	445,396	14.90%

According to the Medicare Part A Agreement No. HCFA 84-001-1.25, Article XV, and Medicare Part B Agreement No. HCFA 84-016-2, Article XVIII, "Subcontracting":

- B. It is the policy of the Government to procure property and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate cost to the Government. In order to achieve this objective, competitive proposals shall be utilized to the maximum practical extent.

Because the subsidiaries were wholly-owned by the Auditee and competitive bidding was not applied, the lowest possible cost to Medicare would be the actual costs incurred by the subsidiaries.

Also, Article V in the Auditee's agreement with Diversitec (a wholly-owned subsidiary), Fees and Payment, states:

...all fees and charges for services to be provided by Diversitec pursuant to this Agreement shall be based upon and include only reasonable costs....

In addition, Articles XIII and XVI of Medicare Agreement Nos. HCFA 84-001-1.25 and HCFA 84-016-2 state:

A. It is the intent of this agreement that the Plan, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$162,865 has been recommended for financial adjustment in accordance with Articles XV, XVIII, and XIII of the Medicare Agreements, calculated as follows:

Service	Recalculated Costs Claimed			Profit Margin	Amount Recommended For Financial Adjustment		
	Medicare Part A	Medicare Part B	Total		Medicare Part A	Medicare Part B	Total
Disaster recovery	\$ 12,374	\$ 51,754	\$ 64,128	12.38%	\$ 1,532	\$ 6,407	\$ 7,939
Information services	28,945	18,439	47,384	0%	-	-	-
Automated input	479,966	487,126	967,092	10.83%	51,980	52,756	104,736
Records storage	4,236	67,032	71,268	0%	-	-	-
Material and equipment management	13,183	82,438	95,621	3.23%	426	2,663	3,089
Printing	35,160	280,956	316,116	14.90%	5,239	41,862	47,101
Total	<u>\$573,864</u>	<u>\$987,745</u>	<u>\$1,561,609</u>		<u>\$59,177</u>	<u>\$103,688</u>	<u>\$162,865</u>

b. The \$5,796 recommended for financial adjustment represents ineligible costs billed by Diversitec to BCBSM. Diversitec's Statement of Operations with Allocations Reports were reviewed for each Diversitec service provided to the Medicare Program to determine whether ineligible costs were claimed. The following ineligible costs were noted:

	<u>Disaster Recovery</u>	<u>Automated Input</u>	<u>Record Storage</u>	<u>Printing</u>
Ineligible costs:				
Entertainment	\$14,554	\$ 6,730	\$ 3,311	\$5,218
Advertising-printed	17,091	-	2,869	-
Advertising- broadcasting	-	-	175	-
Special promotions	5,704	3,281	4,315	
- Contributions	<u>150</u>	<u>750</u>	<u>-</u>	<u>25</u>
Total	<u>\$37,499</u>	<u>\$10,761</u>	<u>\$10,670</u>	<u>\$5,243</u>

According to 48 CFR 31.205-1:

(c) Advertising costs...are unallowable.

Also, 48 CFR 31.205-8 states that:

Contributions and donations are unallowable.

In addition, 48 CFR 31.205-14 states that:

Costs of amusement, diversion, social activities...are unallowable.

Advertising and contributions are specifically unallowable in accordance with Paragraph XV of Appendix B to the Medicare Agreement.

Because Diversitec did not maintain cost records, the ineligible costs were allocated to the Medicare Program based on a percentage of costs charged by each service to the Medicare Program related to total Diversitec revenues.

Therefore, \$5,796 has been recommended for financial adjustment in accordance with Appendix B, Paragraph XV and 48 CFR 31.205-1, 31.205-8, and 31.205-14, calculated as follows:

Service	Total Ineligible Costs	Diversitec Revenues	Medicare Part A		Medicare Part B			Total Recommended for Financial Adjustment	
			Amount Charged	Percent Charged	Allocated Ineligible Costs	Amount Charged	Percent Charged		Allocated Ineligible Costs
Disaster recovery	\$37,499	\$ 2,628,982	\$ 12,374	0.47%	\$ 176	\$ 51,754	1.97%	\$ 739	\$ 915
Information services	-	5,344,911	28,945	0.00%	-	18,439	-	-	-
Automated input	10,761	2,714,178	479,966	17.68%	1,903	487,126	17.95%	1,931	3,834
Records storage	10,670	1,544,320	4,236	0.27%	29	67,032	4.34%	463	492
Material and equipment management	-	2,914,220	13,183	0.00%	-	82,438	0.00%	-	-
Printing	<u>5,243</u>	<u>2,988,679</u>	<u>35,160</u>	1.18%	<u>62</u>	<u>280,956</u>	9.40%	<u>493</u>	<u>555</u>
Total	<u>\$64,173</u>	<u>\$18,135,290</u>	<u>\$573,864</u>		<u>\$2,170</u>	<u>\$987,745</u>		<u>\$3,626</u>	<u>\$5,796</u>

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF H.C. REAL ESTATE COMPANY RECALCULATED COSTS CLAIMED AND
AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1986 through September 30, 1987

<u>Service</u>	<u>Recalculated Costs Claimed</u>			<u>Amount Recommended For Financial Adjustment</u>			<u>Notes</u>
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	
Facility management	<u>\$661,330</u>	<u>\$1,753,181</u>	<u>\$2,414,511</u>	<u>\$41,730</u>	<u>\$110,626</u>	<u>\$152,356</u>	1,2

**BLUE CROSS BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE H-2

for the period October 1, 1986 through September 30, 1987

NOTE 1 - PROFIT

The \$152,356 recommended for financial adjustment represents profit billed by H.C. Real Estate Company (H.C. Real Estate) to Blue Cross and Blue Shield of Michigan (BCBSM). H.C. Real Estate's job cost system did not permit comparison of actual costs to the amount billed. In addition, a profit margin by service could not be calculated because this information was not available. Therefore, the audited financial statements were obtained and a profit margin was calculated, detailed as follows:

<u>H.C. Real Estate 1987 Audited Financial Statements</u>			
<u>Revenues</u>	<u>Expenses</u>	<u>Net Income</u>	<u>Profit Margin</u>
<u>\$33,945,873</u>	<u>\$31,803,770</u>	<u>\$2,142,103</u>	<u>6.31%</u>

According to Medicare Part A Agreement No. HCFA 84-001-1.25, Article XV, and Medicare Part B Agreement No. HCFA 84-016-2, Article XVIII, "Subcontracting":

- B. It is the policy of the Government to procure property and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate cost to the Government. In order to achieve this objective, competitive proposals shall be utilized to the maximum practical extent.

Because the subsidiaries were wholly-owned by the Auditee and competitive bidding was not applied, the lowest possible cost to Medicare would be the actual costs incurred by the subsidiaries.

In addition, Articles XIII and XV of Medicare Agreement Nos. HCFA 84-001-1.25 and HCFA 84-016-2 state:

- A. It is the intent of this agreement that the Plan, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$152,356 has been recommended for financial adjustment in accordance with Articles XV and XVIII of the Medicare Agreements, calculated as follows:

NOTE 1 - PROFIT (continued)

<u>Calculated Amount Claimed</u>			<u>Profit Margin</u>	<u>Amount Recommended For Financial Adjustment</u>		
<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>		<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>
<u>\$661,330</u>	<u>\$1,753,181</u>	<u>\$2,414,511</u>	<u>6.31%</u>	<u>\$41,730</u>	<u>\$110,626</u>	<u>\$152,356</u>

NOTE 2 - INELIGIBLE COSTS

We were unable to perform a review to determine if ineligible costs were billed by H.C. Real Estate in FY 1987 because (1) BCBSM was unable to provide H.C. Real Estate expense general ledgers for 1987; and (2) the H.C. Real Estate audited financial statements for 1987 did not provide a breakdown of the expenses.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

DETAIL OF TOWER MANAGEMENT COMPANY RECALCULATED COSTS CLAIMED AND
AMOUNT RECOMMENDED FOR FINANCIAL ADJUSTMENT

for the period October 1, 1986 through September 30, 1987

<u>Service</u>	<u>Recalculated Costs Claimed</u>			<u>Amount Recommended For Financial Adjustment</u>			<u>Notes</u>
	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	
Disk storage	\$44,340	\$147,104	\$191,444	\$7,216	\$23,882	\$31,098	1
Risk management	6,294	35,373	41,667	1,013	5,755	6,768	1
Financial services	<u>1,128</u>	<u>6,340</u>	<u>7,468</u>	<u>183</u>	<u>1,017</u>	<u>1,200</u>	1
Total	<u>\$51,762</u>	<u>\$188,817</u>	<u>\$240,579</u>	<u>\$8,412</u>	<u>\$30,654</u>	<u>\$39,066</u>	

**BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN**

NOTES TO SCHEDULE H-3

for the period October 1, 1986 through September 30, 1987

NOTE 1 - COSTS RECOMMENDED FOR FINANCIAL ADJUSTMENT - \$39,066

The \$39,066 recommended for financial adjustment is comprised of the following:

	<u>Medicare Part A</u>	<u>Medicare Part B</u>	<u>Total</u>	<u>Reference</u>
Profit billed	\$3,795	\$13,841	\$17,636	Note 1a
Ineligible costs	<u>4,617</u>	<u>16,813</u>	<u>21,430</u>	Note 1b
Total	<u>\$8,412</u>	<u>\$30,654</u>	<u>\$39,066</u>	

- a. The \$17,636 recommended for financial adjustment represents profit billed by Tower Management Company (Tower Management) to Blue Cross and Blue Shield of Michigan (BCBSM). Tower Management's job cost system did not permit comparison of actual costs to the amount billed. In addition, a profit margin by service could not be calculated because this information was not available. Therefore, the audited financial statements were obtained and a profit margin was calculated, detailed as follows:

Tower Management 1987 Audited Financial Statements

<u>Revenues</u>	<u>Expenses</u>	<u>Net Income</u>	<u>Profit Margin</u>
<u>\$5,626,723</u>	<u>\$5,214,202</u>	<u>\$412,521</u>	<u>7.33%</u>

According to Medicare Part A Agreement No. HCFA 84-001-1.25, Article XV, and Medicare Part B Agreement No. HCFA 84-016-2, Article XVIII, "Subcontracting":

- B. It is the policy of the Government to procure property and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate cost to the Government. In order to achieve this objective, competitive proposals shall be utilized to the maximum practical extent.

Because the subsidiaries were wholly-owned by the Auditee and competitive bidding was not applied, the lowest possible cost to Medicare would be the actual costs incurred by the subsidiaries.

In addition, Articles XIII and XV of Medicare Agreement Nos. HCFA 84-001-1.25 and HCFA 84-016-2 state:

A. It is the intent of this agreement that the Plan, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Plan.

Therefore, \$17,636 has been recommended for financial adjustment in accordance with Articles XV, XVIII, and XIII of the Medicare Agreements, calculated as follows:

Service	Recalculated Costs Claimed			Profit Margin	Amount Recommended For Financial Adjustment		
	Medicare Part A	Medicare Part B	Total		Medicare Part A	Medicare Part B	Total
Disk storage	\$44,340	\$147,104	\$191,444	7.33%	\$ 3,251	\$10,783	\$14,034
Risk management fees	6,294	35,373	41,667	7.33%	461	2,593	3,054
Financial services	<u>1,128</u>	<u>6,340</u>	<u>7,468</u>	7.33%	<u>83</u>	<u>465</u>	<u>548</u>
Total	<u>\$51,762</u>	<u>\$188,817</u>	<u>\$240,579</u>		<u>\$3,795</u>	<u>\$13,841</u>	<u>\$17,636</u>

b. The \$21,430 recommended for financial adjustment represents ineligible costs billed by Tower Management to BCBSM. BCBSM was unable to provide Tower Management's expense general ledgers for 1987. Therefore, the audited financial statements were obtained to determine whether ineligible costs were claimed. The following ineligible costs were noted:

Ineligible costs:
Interest \$501,865

According to 48 CFR 31.205-20:

Interest and other financial costs:

Interest on borrowing (however represented), bond discounts, costs of financing and refinancing capital (net worth plus long-term liabilities)...are unallowable...

Because Tower Management did not maintain cost records, the ineligible costs were allocated to the Medicare Program based on a percentage of costs charged to the Medicare Program to Tower revenues.

Therefore, \$21,430 has been recommended for financial adjustment in accordance with 48 CFR 31.205-20, calculated as follows:

Service	Total Ineligible Costs	Tower Revenues	Medicare Part A		Medicare Part B		Allocated Ineligible Costs	Total Recommended for Financial Adjustment	
			Amount Charged	Percent Charged	Amount Charged	Percent Charged			
Disk storage	\$501,865	\$5,626,723	\$44,340	0.79%	\$3,965	\$ 147,104	2.61%	\$13,099	\$17,064
Risk management fees	501,865	5,626,723	6,294	0.11%	552	35,373	0.63%	3,162	3,714
Financial services	501,865	5,626,723	<u>1,128</u>	0.02%	<u>100</u>	<u>6,340</u>	0.11%	<u>552</u>	<u>652</u>
Total			<u>\$51,762</u>		<u>\$4,617</u>	<u>\$188,817</u>		<u>\$16,813</u>	<u>\$21,430</u>

Blue Cross
Blue Shield
of Michigan



Medicare

Rosalee Livingston
Vice President
Government Business Group

600 Lafayette East
Detroit, Michigan 48226

EXHIBIT I

April 14, 1993

Mr. Martin W. O'Neill
Partner
Foxx & Company
700 Goodall Complex
324 West Ninth Street
Cincinnati, OH 45202-1908

Re: Medicare Audit of Subsidiary Administrative Costs

Dear Mr. O'Neill:

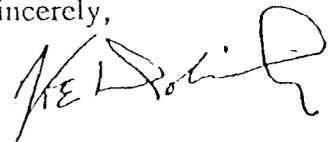
We have reviewed the draft audit report on Subsidiary Administrative Costs and agree with the findings of the report.

During the seven (7) year period of October 1, 1980, through September 30, 1987, Blue Cross and Blue Shield of Michigan (BCBSM) claimed cost on our Medicare contract from our subsidiary companies. These amounts did include profit which we understand is not allowable under our cost reimbursed Medicare contract. BCBSM has recalculated the subsidiary costs and removed profit as well as some expenses such as advertising cost and bad debt expense which were deemed ineligible. BCBSM has restated the subsidiary cost to be \$14,350,833.

Your audit report confirms our recalculation of the subsidiary costs and recommends a financial adjustment of \$1,409,954. BCBSM agrees with the finding and the recommended adjustment of \$1,409,954.

If there are any questions regarding this response you may contact me on (313) 225-0860 or have your staff contact Louis Goring on (313) 225-7374.

Sincerely,


Rosalee Livingston

cc: B. Ball
B. Burdette, OIG
L. Goring