



## Memorandum

Date JAN 28 1997

From June Gibbs Brown  
Inspector General *June G. Brown*

Subject Audit of Administrative Costs - Medicare Parts A and B Blue Cross and Blue Shield of Michigan (A-05 -95-00059)

To Bruce C. Vladeck  
Administrator  
Health Care Financing Administration

This memorandum is to **alert** you to the issuance on January 29, 1997, of our final report. A copy is attached.

The audit covered the costs claimed on Blue Cross and Blue Shield of Michigan's (BCBSM) final administrative cost proposal for Parts A and B of the Medicare Program for Fiscal Years 1994 and 1995. Of the total claimed, we are recommending financial adjustments of \$1,787,345 because **BCBSM**:

- o Claimed \$562,490 in unallowable severance pay for terminated employees, subsequently hired by the replacement contractor.
- o Understated complementary insurance credits applicable to its Medicare secondary payer activities by \$419,003 by not including cost allocations from all cost centers that benefit the complementary claims process and not using the appropriate allocation rates when calculating the applicable credits. Complementary credits are amounts due the Medicare program caused by the redistribution of costs associated with the use of Medicare obtained data for non-Medicare activities.
- o Overstated Medicare costs by \$805,852 for professional consultant fees, post-retirement benefit costs, data entry costs, executive incentive awards and personal use of automobiles which were unreasonable, unallowable, and improperly allocated.

In its response to our draft report, BCBSM generally did not concur with our findings and recommendations.

Page 2- Bruce C. Vladeck

For further information please contact:

Paul Swanson  
Regional Inspector General  
for Audit Services, Region V  
(312) 353-2618

Attachments

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**AUDIT OF ADMINISTRATIVE COSTS -  
MEDICARE PARTS A AND B  
BLUE CROSS AND BLUE SHIELD OF  
MICHIGAN**



**JUNE GIBBS BROWN**  
**Inspector General**

**JANUARY 1997**  
**A-05-95-00059**



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 -95- 00059

Mr. Mark R. Bartlett  
Vice President and Controller  
Blue Cross and Blue Shield  
of Michigan  
600 Lafayette East  
Detroit, Michigan 48226

Dear Mr. Bartlett:

Enclosed for your information and use are two copies of an Office of Inspector General (OIG) audit report entitled "AUDIT OF ADMINISTRATIVE COSTS CLAIMED UNDER PARTS A AND B OF THE HEALTH INSURANCE FOR THE AGED AND DISABLED PROGRAM FOR FISCAL YEARS 1994 AND 1995". 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 within 30 days from the date of this letter. Your response should **present** any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG reports issued to the Department's grantees and 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 above Common Identification Number in all correspondence relating to this report .

Sincerely,

Paul Swanson  
Regional Inspector General  
for Audit Services

Enclosures

Direct Reply to HHS Action Official:  
M. Daly Vargas  
Associate Regional Administrator

SUMMARY

Blue Cross and Blue Shield of Michigan (BCBSM) claimed Medicare Parts A and B administrative costs for the period October 1, 1993 through October 31, 1994, as follows:

<u>Fiscal Year</u>	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
1994	\$14,107,734	\$37,835,418	\$51,943,152
1995	<u>0</u>	<u>2,532,210</u>	<u>2,532,210</u>
Total	<u>\$14,107,734</u>	<u>\$40,367,628</u>	<u>\$54,475,362</u>

Of the \$54,475,362 in administrative costs claimed, we consider \$52,688,017 to be acceptable and recommend a financial adjustment of \$1,787,345 (\$1,129,843 - Part A and \$657,502 - Part B). Details are provided in Exhibits A through D and summarized in the following paragraphs.

We found that Medicare costs were overstated because:

- Costs of \$562,490 claimed as severance pay to employees who were hired by the replacement contractor did not meet the definition of severance pay as provided in the Federal regulations and are unallowable.
- Complementary insurance credits were understated by \$419,003 because BCBSM did not include cost allocations from all cost centers that benefit the complementary claims process and did not use the appropriate allocation rates when calculating the applicable credits.
- Professional consultant costs claimed of \$314,337 were unallowable.
- Post retirement benefit costs were allocated to all lines of business instead of directly identified with the appropriate business segment. As a result, Medicare costs were overstated by \$145,583.
- Data entry costs were overstated by \$134,434 because BCBSM allocated these costs to Medicare using outdated production reports that did not accurately reflect the actual work performed.
- Contingent expenses claimed of \$121,320 were unallowable.
- Executive incentive awards were allocated to Medicare through cost centers that were inconsistent with BCBSM's allocation plan and the allocation of all other executive costs. As a result, Medicare costs were overstated by \$52,812.

- Costs for the personal use of automobiles of \$24,071 were unallowable.
- Miscellaneous income credits were understated and Medicare costs claimed were overstated by \$13,295.

In their written response to our draft report, BCBSM generally did not concur with our findings and recommendations. We have summarized BCBSM'S responses following the individual findings and recommendations and have provided our comments where appropriate. The full text of BCBSM'S written response has been included as an Appendix to this report.

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## INTRODUCTION

### BACKGROUND

Health Insurance for the Aged and Disabled (Medicare) was established by title XVIII of the Social Security Act and consists of two distinct parts. Hospital Insurance (Part A) provides protection against the cost of hospital and related care. Supplemental Medical Insurance (Part B) is a voluntary program that covers physician services, hospital outpatient services, and certain other health services.

The Medicare program is administered at the Federal level by the Health Care Financing Administration (HCFA). Title XVIII provides that HCFA contract with private insurance companies to process claims, record and collect overpayments, and execute the day-to-day operations of the program. For each of these contracts, HCFA and the respective contractor negotiate a budget amount of administrative costs necessary to administer the program. Subsequently, HCFA issues a Notice of Budget Approval (NOBA) to the contractor which establishes the maximum annual costs that can be claimed for reimbursement on the yearend Final Administrative Cost Proposal (FACP).

Through the end of Fiscal Year (FY) 1994, the Medicare program in Michigan was administered by BCBSM. The BCBSM operated as both a fiscal intermediary for the Medicare Part A program and a carrier for the Medicare Part B program. The HCFA opted not to renew BCBSM'S contracts for FY 1995, however, HCFA did provide funding for Part B for October 1994.

### SCOPE OF AUDIT

Our audit was conducted in accordance with generally accepted government auditing standards. The objective was to determine if Medicare Parts A and Part B administrative costs claimed by BCBSM for FYs 1994 and 1995 were reasonable, allocable, and allowable.

We examined the administrative costs claimed by BCBSM to the extent that we considered necessary to determine if amounts claimed were in accordance with applicable Federal requirements, policies, and program instructions. Our examination included audit procedures designed to achieve our objective and included a review of accounting records and supporting documentation.

The audit excluded a review of pension segmentation and this report renders no opinion on those costs. A separate audit of BCBSM'S compliance with pension plan segmentation requirements was performed by our Region VII office, and a final report was issued on November 8, 1996 (CIN: A-07-96-01176).

Audit fieldwork was performed at BCBSM'S offices in Detroit, Michigan during the period June 1994 through March 1995.

FINDINGS AND RECOMMENDATIONS

For the period October 1, 1993 through October 31, 1994, BCBSM claimed Medicare Parts A and B administrative costs \$54,475,362. We consider, \$52,688,017 to be acceptable and recommend a financial adjustment of \$1,787,345. Details of our findings are presented in the following paragraphs.

SEVERANCE PAY

The BCBSM claimed \$562,490 for severance payments (\$525,335 - Part A, \$3,089 - Part B) and the related payroll taxes (\$10,893 - Part A, \$23,173 - Part B) that are unallowable. These payments were made to individuals who continued their employment with the replacement contractor, Health Care Services Corporation (HCSC). In our opinion, these individuals did not sever their employment as defined in Federal regulations.

We noted that HCFA required HCSC, as the replacement contractor, to offer employment to each non-managerial employee displaced by the change in Medicare contractors. We reviewed correspondence and documentation from HCSC, BCBSM, and HCFA to verify each person's continuity of employment. We also obtained a listing of the former BCBSM employees hired by HCSC as of November 4, 1994. We determined that each severance payment claimed by BCBSM was for an employee hired by HCSC. We found that these employees were paid wages and benefits comparable to their compensation at BCBSM and were provided credit for their prior years of service at BCBSM. Because the employees retained their employment under a Medicare contract, there was no severance as defined in 48 CFR 31.205-6(a) (2) and the payments for severance are unallowable. The payroll taxes directly associated with the unallowable severance payments are also unallowable.

Furthermore, HCFA gave BCBSM notification on August 30, 1994 and again on March 3, 1995 that "The government will not pay for severance for those employees who went to work for HCSC."

Recommendation

We recommend that BCBSM make a financial adjustment of \$562,490 as follows:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1994	<u>\$536,228</u>	<u>\$26,262</u>	<u>\$562,490</u>

Auditee Comments

The BCBSM disagrees with the finding. They contend that they are entitled to reimbursement of these costs under the specific terms of the Medicare contract. The BCBSM maintains that the report is

ambiguous as to whether ". . . continuity of employment with credit for prior length of service is preserved under substantially equal conditions of employment. . . ." for the individuals transferred to HCSC. Specifically, they state that the report does not indicate whether the total wage package provided to each HCSC employee was equal to what they received when employed by BCBSM. In addition, BCBSM stated they requested, but have not obtained, a copy of any documents upon which the Office of Inspector General (OIG) may be relying to reach their conclusions.

They stated that the obligation to pay severance arose from HCFA'S termination decision. Consequently, HCFA, with knowledge of BCBSM'S transition and severance pay policies, arranged for HCSC to employ terminated BCBSM Medicare personnel. Further, they indicate that HCFA did not direct them not to pay severance pay and BCBSM could not unilaterally avoid its obligation to make the severance payments resulting from the termination.

It is BCBSM'S position that they are entitled to reimbursement under the specific terms of the Medicare contracts. Both the Parts A and Part B contracts contain clauses that BCBSM was to "...be paid its cost of administration under the principle of neither profit nor loss." The contracts also contain a Termination clause that required BCBSM to ". . . accomplish an orderly transition of its responsibilities to the successor. " The severance compensation was needed to secure an orderly transition by retaining Medicare employees.

#### OIG Response

The OIG believes the severance payments are unallowable. Our opinion regarding equal conditions of employment between HCSC and BCBSM is based, in part, on internal HCSC documents. We did not provide BCBSM with copies of those documents to avoid any confidentiality concerns of HCSC. However, similar information was generally available to BCBSM through exit interviews with employees, job fairs, etc.

As we stated in our finding, HCFA clearly informed BCBSM that severance payments to individuals who went to work at HCSC were unallowable. Although it was HCFA'S decision to terminate BCBSM'S contract, HCFA had no authority over BCBSM'S corporate policy for administering the termination process. The BCBSM felt it's policy obligated the corporation to make severance payments. The HCFA'S only responsibility in this regard was to determine if the resulting payments were eligible for Medicare reimbursement.

The contractor cites the "Termination" clause in the Medicare contract. However, paragraph (C) of the "Termination" clause refers to paragraph B of Article XIII which states "The types of costs allowable and allocable under this agreement shall be determined in accordance with the provisions of Part 31 of the FAR..." The FAR provides that payments made in the event of

employment with a replacement contractor where continuity of employment with credit for prior length of service is preserved under substantially equal conditions of employment are unallowable. In our opinion, these conditions were met for the employees transferred to HCSC. In these circumstances, the FAR does not allow Federal reimbursement for severance paid to these employees. Accordingly, we continue to recommend that BCBSM make the appropriate financial adjustment as reported.

#### COMPLEMENTARY CREDITS

Complementary credits are amounts due the Medicare program caused by the redistribution of costs associated with the use of Medicare obtained data for non-Medicare activities. The BCBSM understated complementary insurance credits applicable to its Medicare secondary payer (MSP) activities causing the FACPS to be overstated by \$419,003. The Medicare Carrier and Intermediary manuals state that any cost center benefiting the complementary claims process must be allocated to that line of business. The activities in the MSP cost centers meet this criteria.

Historically, BCBSM has excluded MSP activities from their complementary credit calculations. However, in 1994, BCBSM completed studies of their Medicare Parts A and Part B complementary credit procedures. The studies state that the methodology for calculating the Medicare complementary credit was carefully scrutinized and that the calculation was revised to reflect operational changes over the past few years. One of these revisions was BCBSM's decision to include the Parts A and Part B MSP cost centers in future calculations of the applicable complementary credits. However, the study provided that the MSP cost centers only partially benefit the complementary process. Therefore, BCBSM significantly reduced the complementary rate applied to the MSP costs that were included in the credit calculation.

Our review of available documentation disclosed no evidence to support BCBSM's contention that the MSP cost centers only partially benefit its complementary insurance programs. In addition, the MSP activities are essential for BCBSM's own insurance programs to ensure compliance with the Federal MSP laws and regulations. The MSP cost centers should be included in the complementary credit calculation the same as other related Medicare claims processing cost centers that have direct contact with Medicare claims. Accordingly, we recalculated the complementary credits using total MSP costs and BCBSM'S established rates for Medicare claims processing activities.

**Recommendation**

We recommend that BCBSM make a financial adjustment of \$419,003, as follows:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1994	\$220,937	\$176,713	\$397,650
FY 1995	<u>0</u>	<u>21,353</u>	<u>21,353</u>
	<u>\$220,937</u>	<u>\$198,066</u>	<u>\$419,003</u>

**Auditees Comments**

The BCBSM disagrees with the finding and recommended adjustment. Specific comments provide that in 1994 BCBSM reviewed its Medicare operations and for FY 1994 included prepayment MSP costs in the complementary credit calculation. The BCBSM contends that HCFA has effectively admitted that it is proper to include only prepayment MSP costs in this calculation and cites HCFA's Program Memorandum AB-95-1 dated January 1995 as support. The BCBSM maintains that its FY94-95 complementary credit calculation is consistent with this memorandum' regarding the treatment of MSP costs in calculating complementary credits.

**OIG Response**

Program Memorandum AB-95-1 does not address or provide guidance with respect to calculating complementary credits using a cost allocation system like BCBSM used during the audit period.

Program Memorandum AB-95-1 revised Medicare's regulations concerning financial policies relating to the release of Medicare claims information for complementary insurance purposes. The revisions represented a major change in how Medicare intermediaries and carriers were to charge for the release of Medicare claims information to complementary insurers. The HCFA established standard rates in an attempt to eliminate the wide disparity of existing contractor complementary insurance rates and the unspecified methodology for developing these rates. The memorandum provided that contractors would no longer determine charges based on their own cost allocations. The standard rates developed using the new methodology were to be implemented effective January 1, 1995, 3 months after the Medicare contract with BCBSM was terminated.

The BCBSM has historically calculated complementary credits using a totally integrated claims processing system. This methodology, used during the audit period, is authorized by the Medicare regulations. However, the regulations require that any activity benefiting the complementary claims process must be allocated. The regulations further provide that an activity would be determined to benefit complementary insurance if that activity would have been necessary to fulfill the terms of the complementary contract or

normal claims processing requirements. We believe that "all" MSP activities benefit the complementary claims process and are essential for BCBSM'S own insurance programs to ensure compliance with Federal MSP laws and regulations. Therefore, we continue to recommend that BCBSM make the appropriate financial adjustments as reported.

**CONSULTANT COSTS**

The BCBSM claimed \$314,337 for consulting services in FY 1994 that are unallowable. The services were rendered by Arthur Andersen & co. to assist BCBSM in a variety of activities including:

(1) revising prior year FACPS; (2) resolving fiscal issues that have an impact on the corporation; and (3) preparing the Medicare transition and termination budgets.

Section II, part I, paragraph B of the Medicare Part A contract states, in part:

"...The prior written approval of the Contracting Officer shall be required. . for the utilization of the services of any consultant under this agreement where such reimbursement exceeds or may exceed \$400.00 per day or \$100,000 per year, exclusive of travel costs. . . ."

These consultant costs exceeded both reimbursement limits, however, BCBSM did not request or receive the required prior written approval. In a letter dated March 3, 1995, HCFA specifically stated that these costs were not reasonable; did not provide any value to the Government; and that the Government would not reimburse BCBSM for these costs.

**Recommendation**

We recommend that BCBSM make a financial adjustment of \$314,337, as follows:

	<u>Part A</u>
FY 1994	<u>\$314,337</u>

**Auditee Comments**

The BCBSM disagrees with our finding and recommendation. They state that the costs were professional service costs for specialized accounting services necessary for the orderly transition and termination of the Medicare contract. They contend that the costs in question were reasonable and would not have been incurred had HCFA not terminated BCBSM'S Medicare contracts. They maintain, therefore, that in accordance with Appendix B, part XIV of BCBSM'S Medicare contracts, pertaining to termination costs, HCFA should reimburse these expenses.

## OIG Response

The costs claimed were for the professional fees and related expenses of outside consultants for accounting related services. As indicated in the finding, those services included activities both related and unrelated to the nonrenewal of the Medicare contract.

The BCBSM's response quotes Appendix B, part XIV of the Medicare contract relating to termination costs. Part I, paragraph B, of Appendix B, however, states that part XIV is simply a guideline for interpreting the FAR. Part I, paragraph A, of Appendix B states that allowable costs are still subject to the limitations of the contract as follows:

"The types of costs allowable and allocable under this agreement/contract, shall be determined in accordance with the provisions of Part 31 of the Federal Acquisition Regulation, subject to the limitations of this agreement/contract . . . . "

As we stated in the finding, the contract established limits on consultant costs and required prior written approval of the Contracting Officer for costs exceeding those limits. The HCFA determined that the consultant costs requested by BCBSM were not reasonable and did not benefit the Government and, therefore, denied approval. Accordingly, we continue to recommend that BCBSM make the appropriate financial adjustment as reported.

## POST-RETIREMENT BENEFITS

The BCBSM allocated employee post retirement benefit (PRB) costs to all lines of business even though most PRB costs can be directly identified to specific business segments. Based on our direct identification of Medicare PRB costs, the amount allocated by BCBSM and claimed for Medicare reimbursement is overstated by \$145,583.

The BCBSM maintains records of the actual PRB costs for each retiree and long-term disabled. Accordingly, information was available to directly identify the PRB costs for Medicare retirees and those retired from the other lines of business. Any residual PRB costs (costs for employees retired from support services that benefit all lines of business) can then be allocated based on current support costs or other equitable method. However, BCBSM elected to allocate the total PRB cost to lines of business based on current personnel costs. This allocation of direct costs is allowed by 48 CFR 31.202, provided the allocation produces substantially the same results as treating the cost as a direct cost .

We requested that BCBSM identify the direct Medicare PRB cost in FY 1994 for comparison with the cost that had been allocated to

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Medicare. We found the costs claimed for Medicare reimbursement were \$145,583 (31 percent) more than the direct Medicare cost plus an equitable portion of the PRB cost for support services.

### Recommendation

We recommend that BCBSM make a financial adjustment of \$145,583, as follows:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1994	<u>\$33,921</u>	<u>\$111,662</u>	<u>\$145,583</u>

### Auditee Comments

The BCBSM commented that the auditors allocated PRB costs to Medicare based on ratios derived from FY 94 salary costs. Because HCFA terminated BCBSM's Medicare contracts in FY 94, there were large scale reductions of Medicare personnel that year. Consequently, BCBSM believes the ratios of Medicare to Corporate salaries are understated and the PRB cost identified to Medicare based on those ratios is also understated.

### OIG Response

The auditee comments are incorrect. As we noted on the supporting documents provided to BCBSM in May 1996, the salary costs used in our calculations were those through September 30, 1994. The "large scale reduction of Medicare personnel" did not begin until October 1994.

Only 26 Government business group employees were released by BCBSM during the year ended September 30, 1994. We determined the salaries of those employees had no significant effect on our calculations. We continue to recommend that BCBSM make the appropriate financial adjustment as reported.

### DATA ENTRY COSTS

We question \$134,434 claimed by BCBSM in FY 1995 for the cost of entering Medicare Part B data into the automated processing system during October 1994. In our opinion, the cost is not allocable to the Medicare program.

The data entry costs are normally allocated between Medicare and other lines of business using rates developed from production reports. The reports identify the hours spent processing data for each of the various business segments each month. We found, however, the rates used to allocate FY 1995 costs included data from FY 1994 production reports. This resulted in nearly 40 percent of the October 1994 data entry costs allocated to

Medicare even though the replacement contractor had assumed the data entry function on October 1, 1994. The October 1994 production data supports only 7.5 percent of the effort as Medicare related. The data entry cost claimed by BCBSM is \$134,434 more than the cost we determined allocable to Medicare using the 7.5 percent allocation rate.

Because the regulations (48 CFR 31.204) allow the reimbursement of costs only to the extent they are allocable to Federal programs, we question the \$134,434 claimed in excess of the cost allocable to Medicare.

### Recommends **tion**

We recommend that BCBSM make a financial adjustment of \$134,434, as follows:

	<u>Part B</u>
FY 1995	<u>\$134,434</u>

### Auditee Comments

The BCBSM concurred with our findings and recommendations.

### CONTINGENT EXPENSES

We found BCBSM inadvertently included \$121,320 for unallowable contingent expenses in the costs claimed on the FY 1995 Part B FACP. Federal regulations (48 CFR 31.205-7'(b)) generally disallow costs for contingencies.

The BCBSM typically charges one cost center with lump-sum amounts when they believe certain costs will occur but the amount of those costs is uncertain. The charges are allocated to the various business segments, including Medicare. These contingent costs are reversed at the end of each calendar year since, by then, the actual costs have been charged to the appropriate cost centers or the contingency never occurred. Because FACPS are prepared for periods ending before the calendar year, a special adjustment is made to exclude the contingent costs from Medicare claims.

We found the adjustment to remove contingent costs from the FY 1995 Part B FACP was based on an interim accounting report. The interim report did not include all the costs allocated to Medicare, and, as a result, the adjustment based on that report did not remove \$121,320 of the contingent expenses charged to Medicare.

**Recommendation**

We recommend that BCBSM make a financial adjustment of \$121,320, as follows:

	<u>Part B</u>
FY 1995	<u>\$121,320</u>

**Auditee Comments**

The BCBSM concurred with our findings and recommendations.

**EXECUTIVE INCENTIVE AWARDS**

Medicare costs for executive bonuses were overstated by \$52,812 as a result of a distribution that was inconsistent with BCBSM's allocation plan and the allocation used for other executive costs. The BCBSM's allocation plan states that any manager responsible for more than one cost center is assigned to a separate cost center and the manager's costs are allocated based on the cost centers supervised. Our review showed that except for incentive compensation, executive costs were allocated in accordance with this established allocation plan. Executive incentive awards were allocated through the Human Resources cost center which was inconsistent with the normal distribution of the executive costs and did not result in an equitable allocation to the benefiting activities. We identified the regularly assigned cost centers for each executive and redistributed the incentive compensation. Based on our redistribution, we determined that Medicare was overcharged by \$52,812.

**Recommendations**

We recommend that BCBSM make a financial adjustment of \$52,812, as follows:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1994	\$7,013	\$44,306	\$51,319
FY 1995	<u>-0-</u>	<u>1,493</u>	<u>1,493</u>
	<u>\$7,013</u>	<u>\$45,799</u>	<u>\$52,812</u>

**Auditee Comments**

BCBSM has not been able to confirm OIG's calculation that \$52,812 was not equitably allocated to Medicare.

**OIG Response**

Our calculations simply allocated the executives' bonuses similar to all other executive compensation. This complies with the BCBSM allocation plan and, in our opinion, provides the most equitable allocation of the incentive awards.

Our initial calculations were checked by BCBSM in March 1996. During May 1996 we found that, unlike Prior years, the 1994 listing of Medicare rates did not include complementary credits. Revision of our initial calculations to include complementary credits reduced the allocation to Medicare by \$4,019. We have made our calculations available to BCBSM representatives.

**PERSONAL USE OF AUTOMOBILES**

The BCBSM claimed \$24,071 that pertained to personal use of executives' privately-owned automobiles. Federal regulations, 48 CFR 31.201-4, state that a cost is allocable to a Government contract if it (i) is incurred specifically for the contract, (ii) benefits both the contract and other work, and can be distributed to them in reasonable proportion of benefits received, or (iii) is necessary to the overall operation of the business. The executives' personal' use of their automobiles does not meet any of the above criteria and, therefore, is an unallowable cost.

**Recommendations**

We recommend that BCBSM make a financial adjustment of \$24,071, as follows:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1994	\$5,411	\$18,230	\$23,641
FY 1995	<u>-0-</u>	<u>430</u>	<u>430</u>
	<u>\$5,411</u>	<u>\$18,660</u>	<u>\$24,071</u>

**Auditee Comments**

The BCBSM concurred with our findings and recommendations and agrees to settle the finding provided it is part of a global settlement of all cost claims relating to their Medicare contracts.

**MISCELLANEOUS INCOME CREDITS**

Costs claimed were overstated by \$13,295 because BCBSM used an improper method to allocate miscellaneous income. Miscellaneous income includes advance seminar fees and income from subsidiary operations .

Federal regulations at 48 CFR 31.201-5 state that the applicable portion of any income relating to any allowable cost shall be

credited to the Government as a cost reduction or by cash refund. The BCBSM correctly quantified the amount of miscellaneous income received, however, the income was allocated based on a cost center and cost center rates that were inconsistent with its established plan for allocating "Corporate" items. We reallocated this amount using BCBSM's corporate General and Administrative rate.

**Recommendation**

We recommend that BCBSM make a financial adjustment of \$13,295, as follows:

	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
FY 1994	\$11,996	\$ 811	\$12,807
FY 1995	<u>-0-</u>	<u>488</u>	<u>488</u>
	<u>\$11,996</u>	<u>\$ 1,299</u>	<u>\$13,295</u>

**Auditee Comments**

The BCBSM concurred with our findings and recommendations.

OTHER MATTERS

The FACP's included \$830,244 ( \$707,034 under Part A in FY 1994 and \$123,210 under Part B in FY 1995 ) that exceeded HCFA's funding limits as established in the final NOBA. In accordance with the Medicare contracts, BCBSM is only entitled to allowable costs up to the total NOBA.

Our audit of the FACP'S disclosed that the amounts claimed contained unallowable costs. We reduced the amounts claimed by the unallowable costs, and the resulting allowable costs were below the NOBA . Therefore, we have not included costs claimed in excess of the NOBAs as a separate finding in this report. However, we are presenting this information for HCFA'S consideration during the final resolution of our Findings and Recommendations.

## EXHIBIT A

BLUE CROSS AND BLUE SHIELD OF MICHIGAN  
 MEDICARE PART A FINAL ADMINISTRATIVE COST PROPOSAL AND  
 THE AUDITORS' RECOMMENDATIONS  
 FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1994

Operation	<b>Administrative costs</b>
Bills Payment	\$ 8,076,880
Reconsiderations & Hearings	347,930
Medicare Secondary Payer	1,813,410
Medical Review & Utilization Review	848,854
Provider Desk Reviews	472,081
Provider Field Audits	470,356
Provider Settlements	209,622
provider Reimbursement	415,795
Productivity Investments	30,000
Benefit Integrity	227,595
Other	<u>1,195,211</u>
Total Administrative Costs Claimed	<u><u>\$14,107,734</u></u>

## RECOMMENDED FINANCIAL ADJUSTMENTS:

1. Severance Pay	\$ 536,228
2. Complementary Credits	220,937
3. Consultant Costs	314,337
4. Post Retirement Benefits	- 33,921
5. Executive Incentive Awards	7,013
6. Personal Use of Automobiles	5,411
7. Miscellaneous Income Credits	<u>11,996</u>
Total Adjustments	<u>1,129,843</u>
Costs Recommended For Acceptance	<u><u>\$12,977,891</u></u>

Note: Explanation of each adjustment is provided in the  
**"Findings and Recommendations"** section of this report.

## EXHIBIT B

BLUE CROSS AND BLUE SHIELD OF MICHIGAN  
 MEDICARE PART B FINAL ADMINISTRATIVE COST PROPOSAL AND  
 THE AUDITORS' RECOMMENDATIONS  
 FOR THE FISCAL YEARS 1994 AND 1995

<u>Operation</u>	<u>Administrative costs</u>
Claims Payment	\$20,777,630
Reviews & Hearings	3,812,756
Beneficiary/Physician Inquiry	5,305,730
Provider Education & Training	469,236
Medical Review & Utilization Review	3,340,126
Medicare Secondary Payer	2,168,972
Participating Physicians	598,590
Productivity Investments	10,281
Benefit Integrity	1,439,812
Other	<u>2,444,495</u>
Total Administrative Costs Claimed	<u>\$40,367,628</u>
 RECOMMENDED FINANCIAL ADJUSTMENTS:	
1. Severance Pay	\$ 26,262
2. Complementary Credits	198,066
3. Post Retirement Benefits	111,662
4. Data Entry Costs	134,434
5. Contingent Expenses	121,320
6. Executive Incentive Awards	45,799
7. Personal Use of Automobiles	18,660
8. Miscellaneous Income Credits	<u>1,299</u>
Total Adjustments	<u>657,502</u>
Costs Recommended For Acceptance	<u>\$39,710,126</u>

Note: Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

EXHIBIT C

BLUE CROSS AND BLUE SHIELD OF MICHIGAN  
 MEDICARE PART B FINAL **ADMINISTRATIVE COST PROPOSAL AND**  
**THE AUDITORS' RECOMMENDATIONS**  
 FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1994

<u>Operation</u>	<u>Administrative costs</u>
Claims Payment	\$19,864,350
Reviews & Hearings	3,582,853
Beneficiary/Physician Inquiry	5,161,816
Provider Education & Training	465,830
Medical Review & Utilization Review	3,250,523
Medicare Secondary Payer	1,982,100
Participating Physicians	567,625
Productivity Investments	10,281
Benefit Integrity	1,348,509
Other	<u>1,601,531</u>
Total Administrative Costs Claimed	<u>\$37,835,418</u>

RECOMMENDED FINANCIAL ADJUSTMENTS:

1. Severance Pay	\$ 26,262
2. Complementary Credits	176,713
3. Post Retirement Benefits	111,662
4. Executive Incentive Awards	44,306
5. Personal Use of Automobiles	18,230
6. Miscellaneous Income Credits	<u>811</u>
Total Adjustments	<u>377,984</u>
Costs Recommended For Acceptance	<u>\$37,457,434</u>

Note: Explanation of each adjustment is provided in the  
**"Findings and Recommendations"** section of this report.

## EXHIBIT D

BLUE CROSS AND BLUE SHIELD OF MICHIGAN  
 MEDICARE PART B FINAL **ADMINISTRATIVE** COST PROPOSAL AND  
 THE AUDITORS' RECOMMENDATIONS  
 FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1995

Operation	<b>Administrative costs</b>
Claims Payment	\$ 913,280
Reviews & Hearings	229,903
Beneficiary/Physician Inquiry	143,914
Provider Education & Training	3,406
Medical Review & Utilization Review	89,603
Medicare Secondary Payer	186,872
Participating Physicians	30,965
Productivity Investments	0
Benefit Integrity	91,303
Other	<u>842,964</u>
Total Administrative Costs Claimed	<u>\$2,532,210</u>

## RECOMMENDED FINANCIAL ADJUSTMENTS:

1. Complementary Credits	\$ 21,353
2. Data Entry Costs	134,434
3. Contingent Expenses	121,320
4. Executive Incentive Awards	1,493
5. Personal Use of Automobiles	430
6. Miscellaneous Income Credits	<u>488</u>
Total Adjustments	<u>279,518</u>
Costs Recommended For Acceptance	<u>\$2,252,692</u>

Note: Explanation of each adjustment is provided in the  
**"Findings and Recommendations"** section of this report .

**Blue Cross  
Blue Shield**  
of Michigan



Mark R. Bartlett, CPA CPCU  
Vice President and Controller

600 Lafayette East  
Detroit, Michigan 48226-2SS8

September 20, 1997

Mr. Alan Peters  
HHS/OIG Office of Audit Services  
801 South Waverly, Room 104  
Lansing, Michigan 489174200

Re: **CIN: A-05-95-00059**

Dear Mr. Peters:

Blue Cross Blue Shield of Michigan (BCBSM) respectfully submits this response to the August 13, 1996 request by the Office of Inspector (OIG) for comments or additional information concerning Draft Audit Report No. A-05-95-00059, entitled "AUDIT OF ADMINISTRATIVE COSTS CLAIMED UNDER PARTS A AND B OF THE HEALTH INSURANCE FOR THE AGED AND DISABLED PROGRAM FOR FISCAL YEARS 1994 AND 1995" (Draft Audit Report). As is set forth in BCBSM'S attached comments upon the Draft Audit Report, BCBSM generally contests the Audit Report's findings and recommendations. BCBSM maintains that it is entitled to reimbursement of costs it has incurred to perform its Medicare contracts during the period covered by this audit.

As you may know, BCBSM has corresponded with HCFA regarding the possibility of a prompt, global resolution of all Medicare contract costs. By way of a letter dated August 16, 1996, HCFA informed BCBSM that "the best way - probably the only way - to come to an agreement on all the open time periods is to wait until all the necessary audit reports are finalized. We will then put all the unresolved issues on the table and work toward reaching an agreement acceptable to all parties." It is BCBSM'S understanding that this FY94-95 audit and a concurrent audit of BCBSM'S transition/termination costs are the last two such audits. It appears to us that the FY94-95 audit has been completed and that the termination audit is near completion. Please inform me at your earliest convenience if HCFA needs anything further to finalize its auditing.

Please contact me at 313-2254922 if you have any questions or if we otherwise may be of assistance.

Sincerely,

BLUE CROSS BLUE SHIELD OF MICHIGAN

&R. Bartlett

MRB/afs  
Attachments

cc: R. Naftaly  
L. DeMoss  
A. Peters  
[REDACTED]  
P. Swanson  
Associate Regional Administrator, Division of Medicare

INTRODUCTION

The following sets forth BCBSM's response to OIG's request for comments on its Draft Audit Report concerning administrative costs incurred under HCFA contracts numbered 88-001-1.25 and 88-016-2 for the administration of Medicare Part A and Part B, respectively, ("Medicare contracts"), during Fiscal Year (FY) 1994 and part of Fiscal Year 1995. BCBSM's comments are organized to address OIG's audit findings in the order in which they appear in the Draft Audit Report. BCBSM's comments reflect our preliminary determinations, submitted for the purpose of meeting OIG's deadline for comments on its Draft Audit Report and to facilitate the settlement of costs. BCBSM reserves the right to submit additional information and alternative bases for challenging the audit results reflected in Draft Audit Report.

BCBSM generally contests all of the Draft Audit Report's disallowance of costs, except where we have expressly stated that BCBSM will not contest a finding. Please understand that any BCBSM statement that it will not contest a finding is based solely upon information available to and considered by us at this time and is intended to be construed as an offer to settle by crediting HCFA with such amounts, provided that such credit is made a part of a global settlement of all of the parties' cost claims relating to our Medicare contracts. We have deferred commenting upon certain items as to which we either lack sufficient information regarding the basis of OIG's findings or are still reviewing these items.

1. TRANSITION/SEVERANCE COSTS

The Draft Audit Report questions \$562,490 of costs paid by BCBSM to its former Medicare personnel. While these costs originally were included in BCBSM's administrative cost submissions, they arise from HCFA's termination of BCBSM's Medicare contracts and its direction that BCBSM provide for an orderly transition.

The Draft Audit Report questions these costs based upon HCFA's contention that it required HCSC to offer substantially equal employment to non-management personnel whose BCBSM Medicare employment was terminated. The Report refers to the payment of "comparable" compensation and the provision of credit for prior BCBSM service. The Report does not allege, and is somewhat ambiguous, as to whether in fact "continuity of employment with credit for prior length of service is preserved under substantially equal conditions of employ merit." See FAR 31 .205-6( a)(2)(i). To illustrate, no mention is made of whether the amount of prior service credit and wage, vacation and retirement terms provided to each HCSC employee were equal to what they received when employed by BCBSM. BCBSM requested, but has not obtained, a copy of any documents upon which OIG may be relying to determine the prior service credit and conditions of employment provided by HCFA to former BCBSM employees.

In any event, as is set forth in BCBSM's termination settlement proposal dated July 9, 1996, it is BCBSM'S position that it is entitled to reimbursement of these costs under the specific terms of its Medicare contracts, In March, 1994, HCFA issued BCBSM notices of termination, while requiring BCBSM simultaneously to complete the FY94 term of its Medicare contracts, provide for an orderly transition of Medicare operations, and execute a mass termination eliminating all of BCBSM'S Medicare positions. In order to fulfill HCFA's mandates, BCBSM provided certain termination severance compensation conditioned upon Medicare employees' remaining with BCBSM until their release. By undertaking these actions, BCBSM was able to ensure that, notwithstanding HCFA's termination notices, Medicare operations remained

properly staffed and functional until a successor contractor selected by HCFA was deemed ready to assume responsibility for Michigan Medicare.

HCFA, and not BCBSM, determined whether BCBSM would be terminated and replaced. HCFA, with knowledge of BCBSM's transition and severance pay policies, arranged for HCSC to employ terminated BCBSM Medicare personnel. Further, HCFA did not direct BCBSM not to pay severance – which would have resulted in the substantial additional cost of defending against the multitude of lawsuits that doubtless would have been filed by terminated Medicare employees if they had not been paid severance. Under the circumstances, BCBSM was not in a position unilaterally to avoid its obligation to provide severance which arose as a result of HCFA's termination.

If BCBSM had, upon receiving termination notices in March, 1994, advised Medicare employees that severance would not be paid if they accepted employment with HCSC - or immediately terminated all Medicare employees in order to help ensure that Medicare personnel would not have the continuity of employment which HCFA alleges precludes severance reimbursement - it would have become impossible for BCBSM (and, later, for HCFA and HCSC), properly to staff and continue Michigan Medicare service through the end of the FY94 terms covered by BCBSM's Medicare contracts. BCBSM instead responsibly complied with HCFA's direction to provide for an orderly transition and provided the severance compensation needed to secure an orderly transition by retaining Medicare employees until no longer needed by BCBSM.

Under the terms of BCBSM's Medicare contracts, HCFA is obligated to reimburse BCBSM for its termination costs. BCBSM's Medicare contracts were awarded on a cost reimbursement basis under which BCBSM was to “be paid its cost of administration under the principle of neither profit nor loss.” See Medicare Part A contract, Art. XIII(A); Medicare Part B contract, Art. XVI(A). They also contain a “Termination” clause that requires BCBSM to “accomplish an

orderly transition of its responsibilities to the successor” contractor and that provides for the allowability of costs incurred to implement a termination. See Medicare Part A contract, Art. XXVI(D)-(E); Medicare Part B contract, Art. XXVIII(D)-(E). BCBSM had not previously accrued and charged HCFA a cost to cover the contingency of abnormal severance costs resulting from a contract termination. Thus, reimbursement would also be consistent with the FARs provision for government participation in its “fair share” of abnormal, mass severance as determined on a “case-by-case basis.” FAR 31 .205-6(g)(2)(iii).

In sum, under the circumstances of this case, reimbursement of the severance component of BCBSM's termination costs is required to comply with the cost reimbursement basis of BCBSM's Medicare contracts, including specifically their Termination clause. BCBSM accordingly contests the Draft Audit Report's recommendation that such costs be disallowed.

## **2. Complementary Credit**

The Draft Audit Report asserts that BCBSM understated complementary insurance credits applicable to Medicare Secondary Payer (MSP) activities, causing FACPS to be overstated by \$419,003. BCBSM contests the Draft Audit Report recommended adjustment of these credits.

BCBSM historically calculated complementary credit in a manner that consistently had been disclosed to and approved by HCFA through its acceptance of such calculations during the contract administrative cost budgeting and reporting process. It is our understanding that, as had been the case with BCBSM, other Medicare intermediaries and carriers likewise had taken the position that MSP activities did not benefit non-Medicare operations and need not be included in the complementary credit calculation.

Beginning in 1994, BCBSM reviewed its then-current Medicare operations. For FY94, BCBSM included pre-payment MSP costs in the complementary credit calculation. The Draft Audit Report finds, in essence, that BCBSM should have included the entire MSP cost center in the complementary cost calculation. HCFA, however, has effectively admitted that it is proper

to include only pre-payment MSP costs in this calculation. HCFA's Program Memorandum AB-95-1, dated January, 1995, reflects the result of HCFA's review of this issue. Program Memorandum AB-95-1 states that, in performing the complementary credit calculation, HCFA computed complementary rates based upon "Schedule D, Line 1" (emphasis added) of HCFA Forms 1523 and 1524. Line 1 of Schedule D covers MSP pre-payment costs; other MSP costs are covered by separate lines of Schedule D and, notably, are not included in HCFA's computation of complementary credit rates.

In sum, BCBSM's FY94-95 complementary credit calculation is consistent with HCFA's own determination, as set forth in Program Memorandum AB-95-1, regarding the treatment of MSP costs in calculating complementary credit. Accordingly, the Draft Audit Report should be revised to rescind its recommendation that BCBSM adjust its complementary credit calculation.

### 3. Accounting Costs

The Draft Audit Report questions \$314,337 of accounting costs incurred by BCBSM, on the grounds that prior approval is required for "consulting" services that exceed certain dollar thresholds. While these costs originally were included in BCBSM's administrative cost submissions, they arise from HCFA's termination of BCBSM's Medicare contracts and its direction that BCBSM provide for an orderly transition. HCFA's termination of BCBSM's Medicare Part A and Part B contracts confronted BCBSM with an extraordinary-cost accounting task. BCBSM needed to obtain specialized accounting services in order to properly implement the transition and termination, including the preparation of BCBSM's transition and termination budgets, final cost statements, and termination settlement proposal.

BCBSM is entitled to recover its Medicare operations costs, including costs of implementing HCFA's termination and direction to provide for an orderly transition. Reimbursement of these professional services costs would comply with the cost reimbursement basis of BCBSM's Medicare contracts, including specifically their Termination clause and FAR 31.205-33 and

31.205-42(g), which provide for the recovery of such professional services costs, While the Draft Audit Report questions these accounting costs by labeling them as “consultant” services not authorized by HCFA, Appendix B, Part XIV of BCBSM's Medicare contracts contain a “Termination Costs” provision that expressly deems allowable and thus authorizes the type of costs questioned by the Draft Audit Report:

Settlement Expenses - reasonable expenses which are incurred by the contractor in preparing its final cost statement and submitted to audit under this agreement/contract and which would not otherwise have been incurred had this agreement/contract not been terminated are allowable.

BCBSM maintains that the accounting costs in question were reasonable and would not otherwise have been incurred had HCFA not terminated BCBSM's Medicare contracts. In accordance with the terms of BCBSM's Medicare contracts pertaining specifically to termination situations, HCFA should reimburse BCBSM's accounting costs.

4. Post Retirement Benefit Costs

BCBSM has not had an opportunity to review OIG's data and calculations underlying this finding and, thus, is not in a position at this time to provide an informed response to the finding.

5. Data Entry Costs

BCBSM has not had an opportunity to review OIG's data and calculations underlying this finding and, thus, is not in a position at this time to provide an informed response to the finding.

6. Continent Expenses

BCBSM has not had an opportunity to review OIG's data and calculations underlying this finding and, thus, is not in a position at this time to provide an informed response to the finding

7. Executive Incentive Awards

BCBSM has not had an opportunity to review OIG's data and calculations underlying this finding and, thus, is not in a position at this time to provide an informed response to the finding.

8. Personal Use of Automobiles

BCBSM will not contest this finding. If, however, the parties are unable to reach agreement upon a overall global settlement, BCBSM would maintain its claim for these costs, on the ground that they are a proper component of the reasonable total compensation provided to Medicare personnel.

9. Miscellaneous Income Credits

BCBSM has not had an opportunity to review OIG's data and calculations underlying this finding and, thus, is not in a position at this time to provide an informed response to the finding.

10. ADMINISTRATIVE COSTS CHALLENGED BASED ON NOBAs

The Draft Audit Report states that \$830,244 (\$707,034 of the FY94 Part A costs and \$123,210 of FY95 Part B costs) exceeded HCFA's latest Notice of Budget Approval (NOBA). Because the Draft Audit Report recommended disallowance of \$1,787,345, OIG concludes that allowable costs did not exceed HCFA's NOBAs. As set forth more fully in BCBSM's response to OIG's audit of FY90-FY93 administrative costs, BCBSM submits that the referenced NOBAs do not constitute a bar to recovery under its Medicare contracts. Consequently, HCFA should be consistent with the cost reimbursement basis of these contracts - reimburse fully the otherwise allowable administrative costs claimed by BCBSM.



Mark R. Bartlett, CPA, CPCU  
VI President and Controller

600 Lafayette East  
Detroit, Michigan 48226-2998

October 4, 1996

Mr. Alan Peters  
HHS/OIG Office of Audit Services  
801 South Waverly, Room 104  
Lansing, Michigan 48917-4200

Re CI'N: A-05 -95-00059

Dear Mr. Peters:

Blue Cross Blue Shield of Michigan (BCBSM) **respectfully** submits this response **to** your request for additional comments concerning certain items in the **Office** of Inspector (OIG)'s Draft Audit Report No. A-05-95-00059, entitled "AUDIT OF ADMINISTRATIVE COSTS CLAIMED UNDER PARTS A AND B OF THE HEALTH INSURANCE FOR THE AGED AND DISABLED PROGRAM FOR FISCAL YEARS 1994 and 1995 :"(Draft preliminary review to date of **the** items in question and supplement BCBSM'S initial comments submitted to you on September 20, 1996).

Please contact meat 313-225-6922 if you have any questions or if **we** otherwise may be of assistance.

Sincerely,

BLUE CROSS BLUE SHIELD OF MICHIGAN

A handwritten signature in cursive script that reads "Mark R. Bartlett".

Mark R. Bartlett

MRB/afs

Attachments

cc: R. Naftaly  
L. DeMoss  
S. Slamar  
P. Swanson  
Associate Regional Administrator, Division of Medicare

#### 4. Post Retirement Benefit Costs

Based upon BCBSM'S review to date of the **draft** audit, it appears that the recommended change in accounting would understate the FY94 **PRB** cash expense attributable to Medicare service. Cash outlays for **PRB** expenses are produced primarily by **personnel** who retired prior to FY94. The draft audit, however, allocates **PRB** costs to Medicare based upon ratios of Medicare to corporate salaries derived from FY94 salary costs. **In** FY94, HCFA terminated BCBSM'S Medicare contracts and, as a result, an abnormal, large scale reduction of Medicare personnel began during FY94 that reduced the ratio of Medicare to corporate salaries. Consequently, for at least the foregoing reason, the draft audit report's reallocation of **PRB** costs appears to understate the **PRB** cost actually attributable to retired Medicare and Medicare support personnel.

#### 5. Data Entry Costs

OIG appears to be correct in its finding as to the rate at which data entry costs should be allocated to Medicare Part B for October, 1994.

#### 6. Contingent Expenses

OIG appears to be correct as to the \$121,320 of contingent expense that should have been included in an adjustment reversing and thus removing such contingent costs charged to FY 1995.

7. **Executive Incentive Awards**

OIG is correct that BCBSM allocated certain executive incentive costs through its Human Resources Cost Center. BCBSM has not been able to confirm OIG's calculation that \$52,812 of such cost "did not result in an equitable allocation to the benefiting activities."

9. **Miscellaneous Income Credits**

BCBSM will not contest OIG'S reallocation of \$13,295 in miscellaneous income credits.