



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Office of Audit Services, Region V
233 North Michigan Avenue
Suite 1360
Chicago, IL 60601

May 24, 2011

Report Number: A-05-09-00101

Jared A. Adair
Senior Vice President, Medicare Division
Wisconsin Physicians Service Insurance Corporation
1717 West Broadway
Madison, WI 53708

Dear Ms. Adair:

Enclosed is the U.S. Department of Health & Human Services (HHS), Office of Inspector General (OIG), final report entitled *Audit of Medicare Part A Administrative Costs for the Period November 5, 2007, Through September 30, 2008 at Wisconsin Physicians Service Insurance Corporation*. We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this 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.

Section 8L of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me, or contact Dave Markulin, Audit Manager, at (312) 353-1644 or through email at David.Markulin@oig.hhs.gov. Please refer to report number A-05-09-00101 in all correspondence.

Sincerely,

/James C. Cox/
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Nanette Foster Reilly
Consortium Administrator
Consortium for Financial Management & Fee for Service Operations
Centers for Medicare & Medicaid Services
601 East 12th Street, Room 235
Kansas City, Missouri 64106

Department of Health & Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF MEDICARE PART A
ADMINISTRATIVE COSTS FOR THE
PERIOD NOVEMBER 5, 2007,
THROUGH SEPTEMBER 30, 2008
AT
WISCONSIN PHYSICIANS
SERVICE INSURANCE
CORPORATION**



Daniel R. Levinson
Inspector General

May 2011
A-05-09-00101

Office of Inspector General

<http://oig.hhs.gov>

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

The designation of financial or management practices as questionable, a recommendation for the disallowance of costs incurred or claimed, and any other conclusions and recommendations in this report represent the findings and opinions of OAS. Authorized officials of the HHS operating divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

Title XVIII of the Social Security Act established the Medicare program. The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contractors, including Part A fiscal intermediaries (FIs) that process and pay Medicare claims submitted by health care providers. Contracts between CMS and the Medicare contractors define the functions to be performed and provide for the reimbursement of allowable administrative costs incurred in the processing of Medicare claims.

The legacy Medicare Part A contract between CMS and Wisconsin Physicians Service Insurance Corporation (WPS) provides that, when claiming costs, WPS must follow cost reimbursement principles contained in Part 31 of the Federal Acquisition Regulation (FAR) and other applicable criteria. After the close of each fiscal year (FY), WPS submits to CMS a Final Administrative Cost Proposal (FACP) reporting Medicare administrative costs. The FACP and supporting data provide the basis for the CMS contracting officer and contractor to negotiate a final settlement of allowable administrative costs.

Effective November 5, 2007, WPS assumed responsibility for processing the Part A workload, currently known as the WPS legacy workload, previously processed by Mutual of Omaha. During FY 2008, the WPS legacy workload included Part A providers located in 49 states. WPS reported Medicare administrative costs totaling \$59,276,946 in its FY 2008 FACP.

OBJECTIVE

Our objective was to determine whether administrative costs WPS reported on its FACP for FY 2008 were reasonable, allowable, and allocable and in compliance with the FAR and other applicable criteria.

SUMMARY OF FINDINGS

Administrative costs reported by WPS on its FY 2008 FACP were generally reasonable, allowable, and allocable and in compliance with the FAR and other applicable criteria. However, WPS reported unallowable costs totaling \$945,610 because it overstated costs for indirect costs (\$871,048), outside professional services (\$39,038), travel (\$26,496), miscellaneous (\$7,144), and other (\$1,884).

RECOMMENDATION

We recommend that WPS decrease its FY 2008 FACP by \$945,610 to reflect the unallowable costs.

WPS COMMENTS

In written comments on our draft report, WPS concurred with our findings regarding full-time employees, legal services, investment administrative fees, leased vehicles, membership dues, and lobbying costs. Regarding related-party transactions, WPS disputed the OIG computation to reduce its costs by \$28,524 and instead said the correct profit it charged to Medicare was \$7,160. WPS disagreed with our finding regarding home office costs and submitted additional documentation to support its position. In addition, WPS did not concur with our findings regarding consultant services, meals, gift and gift cards, and meals and beverages. WPS also commented on misclassified equipment costs, which were acquired under a separate contract. WPS's comments appear in their entirety as Appendix C.

OFFICE OF INSPECTOR GENERAL RESPONSE

We reviewed WPS's comments and analyzed the additional documentation provided and maintain that our findings and recommendation remain valid. We will disclose the misclassified equipment costs under a separate report of WPS's Medicare Part B administrative costs.

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INTRODUCTION

BACKGROUND

Title XVIII of the Social Security Act established the Medicare program. The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contractors, including Part A fiscal intermediaries (FIs) that process and pay Medicare claims submitted by health care providers. Contracts between CMS and the Medicare contractors define the functions to be performed and provide for the reimbursement of allowable administrative costs incurred in the processing of Medicare claims.

The legacy¹ Medicare Part A contract between CMS and Wisconsin Physicians Service Insurance Corporation (WPS) provides that, when claiming costs, WPS must follow cost reimbursement principles contained in Part 31 of the Federal Acquisition Regulation (FAR) and other applicable criteria. After the close of each fiscal year (FY), WPS submits to CMS a Final Administrative Cost Proposal (FACP) reporting Medicare administrative costs. The FACP and supporting data provide the basis for the CMS contracting officer and contractor to negotiate a final settlement of allowable administrative costs.

Effective November 5, 2007, WPS assumed responsibility for processing the Part A workload, currently known as the WPS legacy workload, previously processed by Mutual of Omaha. During FY 2008, the WPS legacy workload included Part A providers located in 49 states. WPS reported Medicare administrative costs totaling \$59,276,946 in its FY 2008 FACP.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether administrative costs WPS reported on its FACP for FY 2008 were reasonable, allowable, and allocable and in compliance with the FAR and other applicable criteria.

Scope

Our review covered the period November 5, 2007, through September 30, 2008 (FY 2008). For this period, WPS reported Medicare Part A administrative costs totaling \$59,276,946. This total included pension costs of \$1,433,518 that we did not review because pension costs will be the subject of a separate review. WPS reported \$3,223,889 of unspent forward funding costs in its FY 2008 FACP.

We reviewed WPS's internal controls related to the claiming of costs on the FACP. We limited our review of internal controls to those controls necessary to achieve our audit objective.

¹ Section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, P.L. No. 108-173, required CMS to transfer the Medicare Part A and Part B workloads to Medicare administrative contractors ("MACs") between October 2005 and October 2011. Accordingly, CMS must transfer all providers serviced in the WPS legacy workload to MACs by October 2011.

We conducted fieldwork at WPS's offices in Madison, Wisconsin.

Methodology

To accomplish the objective, we:

- reviewed applicable Federal laws, regulations, and guidelines;
- reviewed WPS's contract with CMS;
- reviewed internal and external audit reports, including independent auditor's reports and letters related to WPS's internal controls for calendar years 2007 and 2008 and prior Office of Inspector General (OIG) reports for FYs 2004 through 2008;
- interviewed WPS officials regarding the cost accumulation processes for its FACP and cost allocation systems;
- reconciled line item expenses on the FACP and cost classification reports to WPS's accounting records;
- tested costs for reasonableness, allowability, and allocability by reviewing contracts and agreements and by judgmentally selecting journal entries, invoices, expense vouchers and reports, payroll journals, corporate bonus plans, and personnel records; and
- reviewed total compensation paid to the five highest paid executives.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

FINDINGS AND RECOMMENDATION

Administrative costs reported by WPS on its FY 2008 FACP were generally reasonable, allowable, and allocable and in compliance with the FAR and other applicable criteria. However, WPS reported unallowable costs totaling \$945,610 because it overstated costs for indirect costs (\$871,048), outside professional services (\$39,038), travel (\$26,496), miscellaneous (\$7,144), and other (\$1,884) (Appendix B).

UNALLOWABLE COSTS

Indirect Costs

Requirements

Pursuant to FAR 31.201–2 (a), “A cost is allowable only when the cost complies with all of the following requirements: (1) Reasonableness. (2) Allocability. (3) Standards promulgated by the CAS [cost accounting standards] Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances. (4) Terms of the contract ...”

Pursuant to FAR 31.203(a), “For contracts subject to full CAS coverage, allocation of indirect costs shall be based on the applicable provisions.” According to 48 CFR 9903.201-2(a), full CAS coverage requires compliance with all of the CAS specified in 48 CFR part 9904.

Pursuant to 48 CFR § 9904.403-50(c)(1), CAS requires residual home office expenses² to be allocated using the three factor formula, which consists of payroll dollars, operating revenue, and the average net book value of tangible capital assets and inventories.

Federal regulations at 48 CFR § 9904.403-30(a)(3) state that:

Operating revenue means amounts accrued or charge[d] to customers, clients, and tenants, for the sale of products manufactured or purchased for resale, for services, and for rentals of property held primarily for leasing to others. It includes both reimbursable costs and fees under cost-type contracts and percentage-of-completion sales accruals except that it includes only the fee for management contracts under which the contractor acts essentially as an agent of the Government in the erection or operation of Government-owned facilities. It excludes incidental interest, dividends, royalty, and rental income, and proceeds from the sale of assets used in the business.

Home Office Expenses

WPS overstated residual home office expenses by \$857,239 in its FY 2008 FACP due to an incorrect calculation used to allocate these expenses. WPS used the three factor formula to allocate residual home office expenses. However, instead of using the revenue it received from CMS (\$149 million) for the operating revenue portion of the three factor formula, WPS used both the revenue received from CMS plus the amount of Medicare claim benefits paid to providers (\$42 billion) in its cost allocation. As a result, the allocation percentages for the operating revenue factors were overstated which led to WPS overstating residual home office expenses on its FACP for FY 2008.

² Residual expenses are costs incurred by the home office that cannot be identified to a specific contract, group of contracts, or company segment.

Full-Time Employees

WPS overstated its indirect costs on its FY 2008 FACP by \$13,809, because it used an incorrect full-time employees (FTE) allocation rate. The rate was incorrect because it was calculated using an inaccurate FTE count.

WPS overstated indirect costs for home office cost expenses and FTE by \$871,048 in its FY 2008 FACP.

Outside Professional Services

Profit Associated with Related-Party Transactions

Pursuant to Article XII.A of the Medicare Part A contract, “It is the intent of this agreement that the Intermediary, in performing its functions under this agreement, shall be paid its costs of administration under the principle of neither profit nor loss to the Intermediary”

WPS reported unallowable costs on its FY 2008 FACP that included an allocation totaling \$28,524 in profit paid to a wholly-owned subsidiary.

Consultant Services

Pursuant to FAR 31.205-33:

(f) Fees for services rendered are allowable only when supported by evidence of the nature and scope of services furnished Evidence necessary to determine that work performed is proper and does not violate law or regulation shall include --

(1) Details of all agreements (*e.g.*, work requirements, rate of compensation, and nature and amount of other expenses, if any) with the individuals or organizations providing the services and details of actual services performed

WPS reported unallowable costs totaling \$6,200 on its FY 2008 FACP for consultant services. Specifically, WPS was unable to provide a contractual agreement (*e.g.*, description of the services, estimate of time required, rate of compensation, and termination provisions) to support costs it allocated to Medicare. In the absence of adequate supporting documentation, the costs are unallowable.

Legal Services

Pursuant to FAR 31.205-47(f):

Costs not covered elsewhere in this subsection are unallowable if incurred in connection with - ... (8) Protests of Federal Government solicitations or contract

awards, or the defense against protests of such solicitations or contract awards, unless the costs of defending against a protest are incurred pursuant to a written request from the cognizant contracting officer.

WPS reported unallowable legal expenses totaling \$3,805 in its FY 2008 FACP related to a MAC bid that was protested but not requested by the CMS cognizant contracting officer.

Investment Administrative Fees

Pursuant to FAR 31.201-4:

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it – (a) Is incurred specifically for the contract; (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

WPS reported unallowable costs totaling \$509 in its FY 2008 FACP for investment administrative fees related to a 401K plan. Specifically, WPS charged the Medicare contract for the unallowable fees for employees who did not work in the Medicare line of business.

WPS overstated outside professional services related to profit associated with related-party transactions, consultant services, legal services, and investment administrative fees totaling \$39,038 in its FY 2008 FACP.

Travel

Leased Vehicles

Pursuant to FAR 31.205-6(m)(2), “That portion of the cost of company-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable regardless of whether the cost is reported as taxable income to the employees (see 31.205-46(d)).”

WPS reported unallowable costs totaling \$25,478 on its FY 2008 FACP related to the personal use of company-furnished leased vehicles.

Meals

FAR 31.205-14 states, “Costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable. Costs made specifically unallowable under this cost principle are not allowable under any other cost principle.”

WPS reported unallowable costs totaling \$1,018 in its FY 2008 FACP for meals provided during a company Christmas party in December 2007 totaling \$777 and the cost of personal meals provided to executives who were not on travel totaling \$241.

WPS overstated travel costs related to leased vehicles and meals totaling \$26,496 in its FY 2008 FACP.

Miscellaneous

Gifts

Pursuant to FAR 31.205-13(b), “Costs of gifts are unallowable.”

WPS reported unallowable costs totaling \$4,700 in its FY 2008 FACP for gifts and gift cards provided to employees at social events.

Meals and Beverages

Pursuant to FAR 31.205-14, “Costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable. Costs made specifically unallowable under this cost principle are not allowable under any other cost principle.”

WPS reported unallowable costs totaling \$2,444 on its FY 2008 FACP for food and beverages served during company social events.

WPS overstated miscellaneous costs related to gifts and meals and beverages totaling \$7,144 in its FY 2008 FACP.

Other

Membership Dues

Pursuant to FAR 31.205-43(a), costs associated with “[m]emberships in trade, business, technical, and professional organizations” are allowable. However, FAR 31.205-14 provides that “Costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable. Costs made specifically unallowable under this cost principle are not allowable under any other cost principle.”

WPS reported unallowable costs totaling \$1,433 in its FY 2008 FACP for membership dues to attend social events.

Lobbying

Pursuant to FAR 31.205-22(a)(1), “Costs associated with the following activities are unallowable: (1) Attempts to influence the outcomes of any Federal, State, or local election, referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activities”

WPS reported unallowable costs totaling \$451 in its FY 2008 FACP for membership fees associated with lobbying costs.

WPS overstated other costs related to membership dues and lobbying totaling \$1,884 in its FY 2008 FACP.

RECOMMENDATION

We recommend that WPS decrease its FY 2008 FACP by \$945,610 to reflect the unallowable costs.

WPS COMMENTS

In written comments on our draft report, WPS concurred with our findings regarding full-time employees, legal services, investment administrative fees, leased vehicles, membership dues, and lobbying costs. Regarding related-party transactions, WPS disputed the OIG computation to reduce its costs by \$28,524 and instead said the correct profit it charged to Medicare was \$7,160. WPS disagreed with our finding regarding home office costs and submitted additional documentation to support their position. In addition, WPS did not concur with our findings regarding consultant services, meals, gift and gift cards, and meals and beverages. WPS also commented on misclassified equipment costs, which were acquired under a separate contract. WPS’s comments appear in their entirety as Appendix C.

OFFICE OF INSPECTOR GENERAL RESPONSE

We reviewed WPS’s comments and analyzed the additional documentation provided and maintain that our findings and recommendation remain valid. We will disclose the misclassified equipment costs under a separate report of WPS’s Part B administrative costs.

APPENDIXES

**APPENDIX A: COSTS REPORTED ON FINAL ADMINISTRATIVE COST
PROPOSAL BY COST CLASSIFICATION**

Cost Category	Total Costs Claimed
Salaries/Wages	\$25,835,546
Fringe Benefits	10,627,100
Facilities or Occupancy	2,953,796
Electronic Data Equipment	3,666,531
Subcontractors	10,680,615
Outside Professional Services	2,592,013
Telephone & Telegraph	4,822
Postage & Express	216,435
Furniture & Equipment	1,103,318
Materials & Supplies	142,876
Travel	704,908
Return on Investment ¹	0
Miscellaneous	336,632
Other	203,896
Subtotal	59,068,488
Other Adjustments (Credits)	(3,015,431)
Total Costs	\$56,053,057
Forward Funding	3,223,889
Total Costs Claimed on Final Administrative Cost Proposal	\$59,276,946
OIG Recommended Adjustments*	(945,610)
Total Costs after Adjustments	\$58,331,336

OIG = Office of Inspector General

*See Appendix B

¹ WPS did not report any Return on Investment costs

**APPENDIX B: OFFICE OF INSPECTOR GENERAL
RECOMMENDED COST ADJUSTMENTS**

Cost Category	Total Part A Adjustments (FY 2008)
Indirect Costs	\$871,048
Outside Professional Services	39,038
Travel	26,496
Miscellaneous	7,144
Other	1,884
Total OIG Recommended Adjustments	\$945,610

April 14, 2011

Mr. James C. Cox
Regional Inspector General for Audit Services
HHS, Office of Audit Services
233 North Michigan Avenue, Suite 1360
Chicago, IL 60601

RE: Draft OIG Report Number A-05-09-00101
Contract No. HCFA 87-319-1

Dear Mr. Cox:

In a letter dated March 17, 2011, we received the Office of Inspector General's draft report entitled *Audit of Medicare Part-A Administrative Costs for the Period November 5, 2007, Through September 30, 2008 at Wisconsin Physicians Service Insurance Corporation*. In that letter, you requested that we respond to you and include a statement of concurrence or non-concurrence for each recommendation. WPS has included these statements below in the same order that the recommendations appear in the draft report.

We note that the contract is not subject to the Cost Accounting Standards (CAS), except as referenced in Appendix B (10-87) to the contract.

Home Office Costs

WPS does not concur with the OIG recommendation to reduce its costs by \$857,239 related to the revenue components used to determine the allocation of residual home office overhead under the three factor formula set forth in CAS 403. Although the referenced contract is not subject to CAS, WPS changed its allocation methodology to the CAS formula in response to a CMS directive in 2006, prior to WPS' first Medicare Administration Contract (MAC) proposal submission.

OIG references FAR 31.201-2(a), "A cost is allowable only when the cost complies with all of the following requirements: (1) Reasonableness. (2) Allocability. (3) Standards promulgated by the CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances. (4) Terms of the contract...". There are no generally accepted accounting principles relative to the allocation of home office residual expense. Accordingly, under the terms of the contract, any reasonable allocating method should be appropriate. See Contract, Article XII.

While WPS' Medicare Legacy contract is not subject to CAS, WPS has had other contracts that are and have been subject to CAS since the early 1990's. These contracts have been audited by DCAA, WPS' Cognizant Federal Audit Agency, including CAS 403 audits, Business Proposal audits, and Disclosure Statement audits for purposes of WPS' TRICARE and Medicare MAC contracts, which are subject to full CAS. The method of arriving at the component parts of the 3-factor formula

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Mr. James C. Cox
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including the revenue component was specifically reviewed by DCAA and DCAA has never taken exception to WPS' allocation methodology for residual home office overhead since the 2006 application of the three factor formula.

WPS' allocation of residual home office overhead expense has been calculated to be compliant with FAR 31.203. The allocation has been reviewed by DCAA and OIG previously, and has been found to be reasonable and allowable. While the subject Medicare Part A legacy contract is not subject to CAS, WPS' allocation of residual home office overhead has been based on CAS 403 since 2006, has been reviewed by DCAA, and has been found to be CAS compliant.

Provided below is a more detailed explanation supporting WPS allocation calculation for residual home office overhead using the three factor formula:

WPS disagrees with OIG's contention that WPS' methodology for allocating home office expenses deviates from CAS 403 and the three factor formula (per FAR 31.203). To the contrary, WPS believes its allocation methodology for home office expenses is fully compliant with the CAS 403 three factor formula. In response to direction from CMS, WPS changed its methodology for allocating home office expenses to the CAS 403 three factor formula in 2006. WPS has disclosed this allocation methodology for home office expenses in its CAS required Home Office Disclosure Statement. On multiple occasions, DCAA, WPS' Cognizant Federal Audit Agency (CFAA), has reviewed WPS' home office allocation methodology and has deemed it reasonable and adequate (please see attachments 1&2 – DCAA audit of three factor formula). Provided below is a chronology detailing the history of WPS' home office allocation methodology. It demonstrates that WPS implemented its current methodology in response to direction from CMS, is compliant with CAS 403, and has been deemed reasonable and adequate by DCAA.

WPS has held numerous CAS covered contracts on a continuous basis with DoD since 1990, under the OCHAMPUS and TRICARE Managed Care Support programs. In accordance with CAS and the FAR, DoD was designated the Cognizant Federal Agency Official (CFAO) for WPS' TRICARE segment and WPS' home office expenses and has been responsible for administering the Cost Accounting Standards for all of WPS' CAS contracts (See FAR 52.230-6 "Administration of Cost Accounting Standards"). This single point of control within the government for CAS administration is required, because the disclosed practices of a contractor must be consistently applied across all of its CAS covered contracts (See FAR 52.230-2). Having different agencies require different cost accounting practices under different contracts would violate the consistency requirements of CAS.

Since at least 1990, WPS had allocated CAS 403 home office residual expenses on the basis of total administrative expense by segment. This allocation methodology was understood and accepted by both TMA and DCAA. In 2005, CMS directed WPS to revise its allocation methodology for CAS 403 residual home office expenses to the CAS 403 three factor formula, prior to submission of a MAC proposal.

In 2005, CMS held a conference in Baltimore, prior to the award of the first MAC contract, which addressed the requirement that all contractors going forward would be subject to CAS. This conference explained CAS requirements, including Disclosure Statements, established accounting

practices, Cognizant Federal Audit agencies, and home office expenses (Part 8 of the Disclosure Statement). CMS also explained that it would require use of the CAS 403 three factor formula for allocation of residual home office expenses. Unlike other MAC contractors, WPS, under its TRICARE contracts with the DoD, was already subject to CAS and WPS maintained a CAS compliant home office allocation. The use of total administrative expense as the allocation base for the CAS 403 residual pool was identified in WPS' DCAA approved CAS Disclosure Statement for parts one through eight. DCAA was WPS' Cognizant Federal Audit Agency (for Parts 1-7 TRICARE Segment and Part 8 Home Office Expenses). At the time of the CMS conference, although not based on the three factor formula, WPS' home office allocation structure had been reviewed and approved as CAS-compliant by both the DoD appointed CFAO and DCAA.

CAS requires the application of home office expenses consistently across all government contracts, regardless of segment. CMS requested the change to the CAS 403 three factor formula for allocation of residual home office expenses. For calendar year 2006, prior to the award of its first MAC contract, WPS revised its allocation methodology for residual home office expense to the three factor formula and updated its Disclosure Statements accordingly. In accordance with FAR 52.230-6, WPS notified the CFAO of the change through the submission of a revised Disclosure Statement. DCAA, as the CFAA, subsequently reviewed WPS' revised three factor methodology for allocation of residual home office expense, and deemed it reasonable and adequate. For multiple audits, on both Medicare and TRICARE contracts, DCAA and the HHS OIG (Medicare FY 2006) have audited WPS' allocation of home office expense and have found no significant issues related to the requirements of CAS 403. In fact, contrary to the OIG's present assertion, DCAA explicitly found inclusion of benefits payments in revenue as a reimbursed cost to be proper under CAS 403. (See attachments 1&2-DCAA audit of three factor formula).

OIG is specifically questioning the "Revenue" component of the three factor formula. In accordance with CAS, WPS' definition of "revenue" under the formula is an accurate measure of the total activity of each segment in relation to the other segments and has been accepted by DCAA in every audit covering this issue since 2006.

CAS 9904.403-30(3) defines "operating revenue" as including reimbursable costs and fees under cost-type contracts. WPS' Medicare segment pays both administrative and claim payments out of WPS accounts and is separately reimbursed by CMS. WPS' TRICARE segment also makes claims payments out of WPS accounts and is separately reimbursed for those payments. CAS 403 states that such reimbursable costs are to be included in operating revenue under the three factor formula. WPS has accounted for the payments of claims for Medicare and TRICARE as a cost, and the corresponding reimbursement as revenue, on its general ledger since the inception of these business segments over 40 years ago. In addition, DCAA explicitly found benefits payments to be reimbursable costs properly included in revenue under the CAS 403 three factor formula. (See Attachments 1 & 2, DCAA audit of three factor formula).¹

OIG's position is that inclusion of the claims paid as revenue, for Medicare and TRICARE, has the effect of over-allocating home office expenditures to government contracts. To the contrary, WPS' position is that the exclusion of the reimbursement for claim payments as revenue would inequitably and inappropriately understate the allocation of residual home office expense to WPS' Medicare and

¹ Office of Inspector General Note-The attachments were removed because it is proprietary information.

TRICARE segments that perform administrative services for claims payment contracts. Exclusion would also contravene WPS' DCAA-approved CAS Disclosure Statements, and the basic purpose of CAS 403 that "beneficial or causal relationships" between home office expenses and receiving segments should be the basis for the allocation method selected. An allocation method that distorts the relative benefits received by WPS' various segments would be inconsistent with the requirements of the CAS.

CAS9904.403-50(c)(1) identifies "three broad areas of management concern" used in the allocation formula: the employees of the organization, **the business volume**, and the capital invested in the organization. There can be no question that WPS has, is and will always consider its fiduciary responsibility, related to the payment of claims for our government segments, equal to that of WPS' commercial segment. Aside from WPS' fiduciary duties, WPS has material positive incentives, error penalties, and various award fees, related to the accuracy of claim payments for its two government segments. These financial incentives ensure that WPS approaches the payment of claims equally across its various business segments, whether they are made on an administrative services basis or an insured basis. The appropriate, reasonable and consistent position is to consider business volume on the basis of revenue that covers both administrative and claim costs equally for all segments, government and commercial. OIG's position would result in over-allocation of home office expenses to the commercial side of the business and distortion of the actual costs benefitting WPS' various business segments.

Claim payments typically run approximately eight times higher than the corresponding administrative costs necessary to process the claim. OIG's position would mean that, from a business volume perspective, the WPS commercial risk volume would count eight times that of its Medicare and TRICARE volume. This approach would lead to an unreasonable result and would be inconsistent with the intent of the three factor formula to properly reflect the relative business volume among segments and to achieve an overall allocation base representative of the total activity across all business segments. While WPS' commercial segment processes approximately 6 million claims annually, the Medicare and TRICARE segments process over 150 million claims and 60 million claims, respectively. Yet under OIG's approach, from a business volume perspective, WPS' commercial business segment would be considered over three times the size of either government segment.

To further illustrate this point, when comparing the current three factor formula calculation used by WPS to the methodology used by WPS prior to 2006 (i.e., administrative expenses by business segment), the allocation rates are materially comparable. Prior to CMS requiring WPS' use of the three factor formula in 2006 under the MAC contracts, OIG had audited over forty years of Medicare costs and had never taken exception to WPS' allocation of home office residual expenses. In contrast, using OIG's approach to the three factor formula calculation would lead to a material change in allocation results that would not be representative of the actual relative business activity across WPS' government and commercial business segments.

WPS top management is deeply involved in business operations across all of the company's segments. To illustrate the need for WPS' top management involvement, several examples of contract deliverables are provided. Regulatory requirements such as DIACAP, Service Contract Act

compliance, preparation of proposals in response to RFP's, FISMA compliance, Certification Package for Internal Controls (CPIC), management of government audits including SAS 70 (in 2010 alone, the Medicare Business Segment has had 12 external audits), and contract modifications (just to name a few) command a greater proportional share of WPS' top management time than does WPS' commercial segment.

To summarize, there is no basis for challenging WPS' DCAA-approved allocation methodology for residual home office overhead under the CAS 403 three factor formula. OIG's position would lead to a result contrary to the basic intent of the three factor formula by distorting the allocation of these costs to WPS' various business segments. WPS' application of the three factor formula has been fully disclosed to the CFAO and repeatedly approved in government audits. And, there is no basis for excluding claim payment reimbursement from operating revenue in applying the three factor formula.

Full Time Employees

WPS concurs with the OIG recommendation to reduce its costs by \$13,809 related to using an incorrect FTE allocation caused by using an incorrect formula to calculate the FTE count. WPS is reviewing the allocation formulas on a quarterly basis to provide reasonable assurance that there are no errors going forward.

Related Party Transactions

WPS does not concur with the OIG recommendation to reduce its costs by \$28,524 related to profit for temporary help and technical services provided by a wholly owned subsidiary of WPS. The OIG overstated the subsidiary's profit by \$78,162. The correct profit charged to Medicare is \$28,162, \$7,160 of which is related to Part A. The OIG calculation did not consider indirect costs for the subsidiary as a ratio of all indirect costs to all direct costs, but as a ratio of a subset of indirect costs to all direct costs resulting in an erroneous indirect rate which overstates the subsidiary profit amount.

WPS agrees to reduce its costs claimed by \$7,160 as profit for temporary help and technical services provided by a wholly owned subsidiary. When the WPS fiscal year end results are final, WPS evaluates the subsidiary profit or loss and adjusts its costs claimed as appropriate.

Consultant Services

WPS does not concur with the OIG recommendation to reduce its costs by \$6,200 for consulting services. The consultant services were performed under an oral contract agreement. The OIG was provided the invoice copy backup showing approval of the services provided, hours worked, and rate of compensation. The total amount paid to this consultant in 2007 and 2008 of \$14,627 is much less than the cost of employing an individual with similar qualifications. Therefore this cost is allowable under FAR 31.205-33 (d),:

In determining the allowability of costs (including retainer fees) in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the contracting officer shall consider the following factors, among others:

- (1) The nature and scope of the service rendered in relation to the service required.*

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(2) The necessity of contracting for the service, considering the contractor's capability in the particular area.

(3) The past pattern of acquiring such services and their costs, particularly in the years prior to the award of Government contracts.

(4) The impact of Government contracts on the contractor's business.

(5) Whether the proportion of Government work to the contractor's total business is such as to influence the contractor in favor of incurring the cost, particularly when the services rendered are not of a continuing nature and have little relationship to work under Government contracts.

(6) Whether the service can be performed more economically by employment rather than by contracting.

(7) The qualifications of the individual or concern rendering the service and the customary fee charged, especially on non-Government contracts.

(8) Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, termination provisions).

Legal Services

WPS concurs with the OIG recommendation to reduce its costs by \$3,805 for legal expenses for protest fees relating to a Medicare Administrative Contractor bid which were not requested by the contracting officer. WPS will include future protest fees in its protest cost center, which are not claimed for reimbursement under this contract.

Investment Administrative Fees

WPS concurs with the OIG recommendation to reduce its costs by \$509 for investment administrative fees related to a 401(k) plan. The employees in the plan who are not part of the Medicare division will have their 401k administrative fees charged based on the Medicare allocation for their cost center.

Leased Vehicles

WPS concurs with the OIG recommendation to reduce its costs by \$25,478 related to the personal use of company furnished leased vehicles. WPS now excludes these costs as unallowable costs.

Meals

WPS does not concur with the OIG recommendation to reduce its costs by \$777 for meals provided during a board of directors meeting. Incidental costs associated with board of director meetings are allowable under FAR 31.205-28 (*"the following types of recurring costs are allowable: (f) Incidental costs of directors' and committee meetings"*). WPS concurs with reducing its costs by \$25 for the alcohol served with the meal. WPS will classify any alcohol purchase as "entertainment", which is not claimed for reimbursement from the government.

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WPS does not concur with the OIG recommendation to reduce its costs by \$241 for meals provided to executives. These expenses are indirect costs in the General Administrative cost pool and are allocated to Medicare in the same manner used for all General Administrative costs in accordance with *FAR 31.203(c)*:

The contractor shall accumulate indirect costs by logical cost groupings with due consideration of the reasons for incurring such costs. The contractor shall determine each grouping so as to permit use of an allocation base that is common to all cost objectives to which the grouping is to be allocated. The base selected shall allocate the grouping on the basis of the benefits accruing to intermediate and final cost objectives. When substantially the same results can be achieved through less precise methods, the number and composition of cost groupings should be governed by practical considerations and should not unduly complicate the allocation.

As indicated in the above referenced FAR provision, it is not appropriate to “cherry-pick” individual expense items out of an indirect pool for disallowance and then pay only a fraction of the Medicare specific expenses in the same pool.

WPS agrees to reduce its costs claimed by \$39 for the meal costs for which it has no receipts. WPS will review expense reports for receipts and request a signed affidavit from the traveler for amounts not supported with a receipt.

Gifts and Gift Cards

WPS does not concur with the OIG recommendation to reduce its costs by \$4,700 for gifts and gift cards. The gift cards were provided under a WPS policy in recognition for years of service in the Medicare line of business. As these are earned by employees through length of service in the Medicare program, they are allowable as compensation. See *FAR 31.205-6(f)(i)* (“Awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment; and (ii) Basis for the award is supported.”)

The gifts are incidental mementos related to WPS’ annual all employee meeting to encourage attendance and to help employees remember goals. The company president and senior executives address the employees on the company’s accomplishments over the previous year, current and future goals, and motivate employees to meet the company’s current and future goals. These costs are allowable under *FAR 31.205-13(a)* (“Aggregate costs incurred on activities designed to improve working conditions, employer-employee relations, employee morale, and employee performance (less income generated by these activities) are allowable”)

Meals and Beverages

WPS does not concur with the OIG recommendation to reduce its costs by \$2,444 for meals and beverages. The meals and beverages are related to WPS’ annual all employee meeting. The company president and senior executives address the employees on the company’s accomplishments over the previous year, current and future goals, and motivate employees to

meet the company's current and future goals. These costs are allowable under *FAR 31.205-13(a), Aggregate costs incurred on activities designed to improve working conditions, employer-employee relations, employee morale, and employee performance (less income generated by these activities) are allowable.*

Membership Dues

WPS does concur with the OIG recommendation to reduce its costs by \$1,433 for membership dues to attend social events. WPS excludes these costs as unallowable costs.

Lobbying

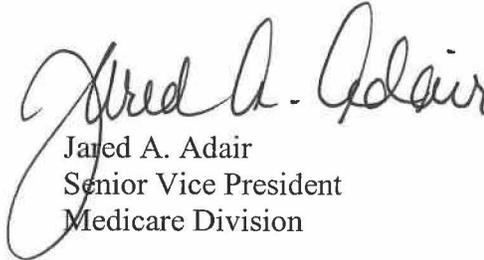
WPS does concur with the OIG recommendation to reduce its costs by \$451 for lobbying costs. WPS now includes these costs in its lobbying cost center, which are not claimed for reimbursement.

Other Topic Not Discussed in the Audit Report

As discussed with the OIG, certain equipment items acquired in connection with the Part-A contract in the amount of \$269,221 were claimed under Part-B and should be reclassified as Part-A costs. These costs are not included in Appendix C: Comparison of Administrative Costs Reported to Budget Authorization schedule.

Thank you for the opportunity to comment, please contact me at (608) 301-2639 or e-mail me at Jared.Adair@wpsic.com if you have any questions.

Sincerely,



Jared A. Adair
Senior Vice President
Medicare Division