



October 14, 2003

Common Identification Number: A-06-03-00013

Mr. Dennis Robertson  
Senior Vice President, Government Programs  
Arkansas Blue Cross Blue Shield  
601 Gaines Street  
Little Rock, AR 72203-2181

Dear Mr. Robertson:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General report entitled, "Administrative Costs Incurred Under Parts A and B of the Health Insurance for the Aged and Disabled Program - Arkansas Blue Cross Blue Shield, Little Rock, Arkansas." A copy of this report will be forwarded to the action official noted below for his review and any action deemed necessary.

The objective of the audit was to determine whether the final administrative cost proposals (cost proposals) fairly present the costs of program administration. This audit was performed at the request of the Centers for Medicare and Medicaid Services. Audit fieldwork was performed at the offices of Arkansas Blue Cross Blue Shield (Blue Cross), Little Rock, Arkansas from November 2002 through May 2003.

Blue Cross claimed costs that did not meet the requirements of Part 31 of the Federal Acquisition Regulations regarding allocability and allowability. Of the \$234,056,106 in administrative costs claimed by Blue Cross during the four fiscal years, we are recommending a financial adjustment of \$689,546 to the cost proposals and setting aside \$70,202. We are recommending that the remaining \$233,296,358 be accepted for reimbursement.

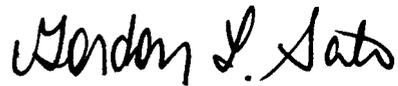
Final determination as to actions taken on all matters reported will be made by the HHS action official named below. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe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

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Please send us your final management decision, including any action plan, appropriate, within 60 days. If you have any questions or comments about this report, please do not hesitate contact William G. Shrigley at (501) 225-8114, ext. 29 or through e-mail at [wshrigley@oig.hhs.gov](mailto:wshrigley@oig.hhs.gov). To facilitate identification, please refer to report number A-06-03-00013 in all correspondence.

Sincerely,

A handwritten signature in black ink that reads "Gordon L. Sato". The signature is written in a cursive style with a large initial "G" and a stylized "S".

Gordon L. Sato  
Regional Inspector General  
for Audit Services

Enclosures

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Direct Reply to HHS Action Official:

Mr. James R. Farris, M.D.  
Regional Administrator  
Centers for Medicare & Medicaid Services  
1301 Young Street, Room 714  
Dallas, TX 75202-4348

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**ADMINISTRATIVE COSTS INCURRED  
UNDER PARTS A AND B OF THE  
HEALTH INSURANCE FOR  
THE AGED AND DISABLED  
PROGRAM – ARKANSAS  
`BLUE CROSS AND BLUE SHIELD,  
LITTLE ROCK, ARKANSAS**



**Inspector General**

**OCTOBER 2003**

**A-06-03-00013**

# *Office of Inspector General*

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# EXECUTIVE SUMMARY

## OBJECTIVE

The audit objective was to determine whether the final administrative cost proposals (cost proposals) fairly present the costs of program administration. This audit was performed at the request of the Centers for Medicare & Medicaid Services. Audit fieldwork was performed at the offices of Arkansas Blue Cross Blue Shield (Blue Cross), Little Rock, Arkansas from November 2002 through May 2003.

This final report provides the results of our audit of administrative costs incurred under Parts A and B of the health insurance for the aged and disabled program. Blue Cross is entitled to reimbursement for its allowable administrative costs incurred. For the period October 1, 1998 through September 30, 2002, Blue Cross claimed administrative costs for Medicare Part A and Part B as follows:

<u>Fiscal Year</u>	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
1999	\$ 12,835,419	\$ 44,322,773	\$ 57,158,192
2000	10,348,572	49,737,254	60,085,826
2001	8,659,128	49,460,045	58,119,173
2002	<u>7,377,017</u>	<u>51,315,898</u>	<u>58,692,915</u>
<b>Total</b>	<u>\$39,220,136</u>	<u>\$194,835,970</u>	<u>\$234,056,106</u>

## FINDINGS

- Blue Cross claimed **subcontract** costs that did not meet the requirements of Part 31 of the Federal Acquisition Regulations (FAR) regarding allocability. Also, Blue Cross claimed subcontract costs that did not meet the requirements of the Medicare Intermediary Manual regarding record retention. These costs were either not related to Medicare or no documents were available to make that determination. We are questioning \$530,895 of subcontract costs claimed on the cost proposals for Fiscal Years 1999 - 2002.
- Blue Cross claimed **related party** costs that did not meet the requirements of FAR Part 31 regarding costs from entities or affiliates of the contractor. The cost of programming services provided by those entities was in excess of the actual cost of those services. We are questioning \$47,217 in excess related party costs claimed on the cost proposal for Fiscal Year 1999. Additionally, we are setting aside \$70,202 in undocumented employee costs on the cost proposals for Fiscal Years 1999 and 2000.
- Blue Cross reported **executive compensation** costs in excess of the maximum specified by Section 39 of Office of Federal Procurement Policy concerning personal services compensation. We are questioning \$72,513 in executive compensation costs claimed on the cost proposals for Fiscal Year 1999 - 2002.

- Blue Cross claimed *tuition* costs that did not meet requirements of FAR Part 31 regarding allocability. Tuition charges were not specifically related to Medicare. We are questioning \$27,151 in tuition costs claimed on the cost proposal for Fiscal Year 1999.
- Blue Cross included a *general contingency reserve* in the cost of a dental program, which was allocated to Medicare. In accordance with FAR Part 31, general contingency reserve is an unallowable cost. We are questioning \$7,036 in contingency costs claimed on the cost proposals for Fiscal Years 1999 – 2002.
- Blue Cross claimed *post retirement health benefit* cost for Fiscal Year 2002. Blue Cross determined that this cost should not be allocated to Medicare and subsequently made an adjustment to remove the cost. However, due to an error the entire balance was not removed. We are questioning \$2,411 in post retirement health benefit cost claimed on the cost proposal for Fiscal Year 2002.
- Blue Cross claimed costs for professional services rendered in connection with *Supplemental Savings Plan*. In accordance with FAR Part 31 requirements, Supplemental Savings Plan is a non-qualified plan; therefore, any cost incurred to administer the plan is unallowable. We are questioning \$2,323 in professional services associated with the Supplemental Savings Plan claimed on the cost proposal for Fiscal Year 2002.

### **RECOMMENDATION**

Of the \$234,056,106 in administrative costs claimed by Blue Cross during the four fiscal years, we are recommending a financial adjustment of \$689,546 to the cost proposals and setting aside \$70,202. We are recommending that the remaining \$233,296,358 be accepted for reimbursement. These amounts are discussed in detail in the Findings and Recommendations section of the report.

### **Blue Cross Response**

Blue Cross concurred in \$624,952 of our recommended financial adjustments (Subcontract Costs-\$530,895, Executive Compensation-\$55,136, Tuition Costs - \$27,151, General Contingency Reserve - \$7,036, Post Retirement Health Benefit - \$2,411 and Supplemental Savings Plan - \$2,323). Blue Cross disagreed with \$64,594 of our financial adjustments (Related Party- \$47,217 and Executive Compensation - \$17,377) and the \$70,202 of set aside costs (Related Party). Blue Cross' written comments are summarized at the end of each finding and are attached as an Appendix to this report.

### **OIG Comments**

We continue to believe that our recommendations for financial adjustments totaling \$689,546 are appropriate. Our comments are summarized at the end of each finding.

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# INTRODUCTION

## **BACKGROUND**

Health Insurance for the Aged and Disabled (Medicare) was established by Title XVIII of the Social Security Act. Hospital Insurance (Part A) provides protection against the costs of hospital inpatient care, post-hospital extended care and post-hospital home health care. Supplemental Medical Insurance (Part B) is a voluntary program providing protection against the costs of physician services, hospital outpatient services, home health care services and other health services. The Medicare program is administered by the Centers for Medicare & Medicaid Services (CMS).

Title XVIII provides that public or private organizations (known as intermediaries for Part A and carriers for Part B) may assist in the program's administration. Arkansas Blue Cross Blue Shield (Blue Cross) serves as a Part A intermediary and a Part B carrier. Blue Cross performs Part B administrative functions for the states of Arkansas, Louisiana, Oklahoma, New Mexico and Missouri. Administrative functions for Missouri were added in fiscal year (FY) 1999. Blue Cross participates in the Medicare program as a data center. Currently, data center services are provided to ten contractors.

## **SCOPE OF AUDIT**

Our audit was conducted in accordance with generally accepted government auditing standards with one exception. Due to time constraints, we did not evaluate the internal controls. The audit objectives were as follows:

- Ascertain whether the final administrative cost proposals (cost proposals) fairly present the costs of program administration and are allowable in accordance with Part 31 of the Federal Acquisition Regulations (FAR) as interpreted and modified by the Medicare agreements; and
- Determine whether executive compensation amounts charged to the Medicare program do not exceed the benchmark compensation amount set forth by Section 39 of the Office of Federal Procurement Policy (OFPP) Act (41 U.S.C. 435).

Our examination included audit procedures designed to accomplish our audit objectives and examination of pertinent accounting records and supporting documentation. The audit period covered costs reported from October 1, 1998 through September 30, 2002. Audit fieldwork was performed at the offices of Blue Cross, Little Rock, Arkansas from November 2002 through May 2003.

Subsequent to our fieldwork, Blue Cross filed a revised cost proposal with CMS for FY 2002. This revised cost proposal had decreases in claimed costs of \$33,904 for Part A and \$69,280 for Part B, totaling \$103,184. Since these adjustments to costs occurred outside the scope of our audit, we do not express an opinion on the \$103,184 difference.

# FINDINGS AND RECOMMENDATIONS

## SUBCONTRACT COSTS

Blue Cross included \$530,895 in subcontract costs that were inappropriately charged to Medicare. Blue Cross improperly included a total of \$527,012 for hardware/software depreciation and systems maintenance cost related to subcontracts for claims imaging. The costs were included in the cost proposals for FYs 2000 - 2002 when Medicare claims were not included in the imaging process.

Blue Cross also allocated \$2,823 of costs found to be unrelated to Medicare. The costs were for advertising, legal and other costs related only to Blue Cross private lines of business. Medicare was charged a portion of these costs during FYs 1999 - 2002 because the invoices were coded and charged to an interim line of business, which included a final allocation to one or more Medicare lines of business.

Section 31.201-2 of the FAR requires that allowable costs must be allocable. Specifically, Section 31.201-4 states:

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.

Additionally, we had instances where supporting documentation was not properly retained. The missing documentation related to charges totaling \$1,060 that was allocated to Medicare.

According to Section 2982 (6) of the Medicare Intermediary Manual,

Intermediary Administrative Budget Estimate and Cost Report Files. These files consist of all uses of the Administrative Cost and Budget Report, Form HCFA-1523. This form is a multi-use document and is used for budget and cost reporting activities...

DISPOSITION: Destroy 3 years after HHS audit and final settlement.

Therefore, we are questioning this amount as follows:

<u>Fiscal Year</u>	<u>Part A</u>	<u>Part B</u>	<u>Total Subcontract Costs</u>
1999	\$232	\$1,584	\$1,816
2000	1,148	96,645	97,793
2001	4,769	218,239	223,008
2002	<u>878</u>	<u>207,400</u>	<u>208,278</u>
Total	<u>\$7,027</u>	<u>\$523,868</u>	<u>\$530,895</u>

## **Recommendation**

We recommend that Blue Cross make a financial adjustment of \$530,895 to the cost proposals.

## **Blue Cross Response**

Blue Cross concurred with our recommendation.

## **RELATED PARTY TRANSACTIONS**

Blue Cross included \$47,217 in excess cost for programming services provided by related entities. Also, Blue Cross included \$70,202 in cost for programming services where the reasonableness could not be determined. These programming services were provided by USABLE Systems (USABLE) and the Arkansas Data Center (Data Center).

### **USABLE Systems**

Blue Cross included \$931 of unallowable costs in the FY 1999 cost proposal for programming services provided by its subsidiary USABLE. These charges were in excess of what USABLE paid contract programmers for these services. We are also setting aside \$21,595 for programming services included in the FY 1999 and FY 2000 cost proposals. These charges were in excess of what USABLE paid staff programmers. We were unable to determine the reasonableness of this difference due to lack of documentation for USABLE fringes and other employee-associated costs and are therefore setting this amount aside.

### **Arkansas Data Center**

Blue Cross also included \$46,286 of unallowable costs in the FY 1999 cost proposal for programming services provided by Data Center contract and staff programmers. This also includes charges from USABLE programming services. These charges were in excess of the amount paid for Data Center and USABLE contract programmers and the amount billed to the Data Center by USABLE for staff services. These services were included in the cost proposal at the \$80 and \$100 hourly rates included in the original Data Center proposal submitted to CMS in 1997. However, the contract programmers were paid \$50 to \$80 per hour and staff programmers were paid \$17.65 to \$40.99 per hour.

We are also setting aside \$48,607 for programming services included in the FY 1999 cost proposal. These charges were in excess of the amount paid to Data Center and USABLE staff programmers. We were unable to determine the reasonableness of this difference due to lack of documentation for fringes and other employee-associated costs.

We consider these excess charges related to USABLE and Data Center unallowable per FAR 31.205-26(e), which states:

Allowance for all materials, supplies, and services that are sold or transferred between any divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control shall be on the basis of cost incurred...

## **Recommendation**

We recommend that Blue Cross make a financial adjustment of \$47,217 (\$931 + \$46,286) to the cost proposal for FY 1999 and that CMS evaluate the \$70,202 (\$21,595 + \$48,607) set aside related to the cost proposals for FYs 1999 and 2000.

## **Blue Cross Response**

Blue Cross disagreed with this recommendation. Blue Cross stated that these costs were related to Arkansas Data Center services billed to users at a predetermined rate and not under a cost contract. Blue Cross stated that the billings were based on understandings between CMS, Blue Cross Blue Shield Association, Data Center and Data Center users.

## **OIG Comments**

Federal Acquisition Regulation 31 requires that any costs transferred between a division or subdivision of the contractor under a common control should be on the basis of cost incurred. We believe that since the Data Center is under the control of Blue Cross, Medicare should not be billed in excess of actual costs incurred. In addition, a portion of the excess charged costs was related to USABLE, a subsidiary, and not billed through the Data Center. (See USABLE Systems section above). Therefore, we continue to believe that our recommendations for financial adjustments are appropriate.

## **EXECUTIVE COMPENSATION COSTS**

Blue Cross reported executive compensation costs that exceed the benchmark compensation amount as required by Section 39 of the Office of Federal Procurement Policy (OFPP) Act (41 U.S.C. 435). Blue Cross has procedures in place to adjust for executive compensation that exceeds the benchmark. These procedures were put in place following recommendations made by the Office of Inspector General during the prior audit of administrative costs for FYs 1995 - 1998. Blue Cross made adjustments for executive compensation for fiscal year FYs 1999 - 2002. However, we determined that additional adjustments of \$72,513 should be made.

For FY 1999, the procedures used by Blue Cross to calculate the executive compensation adjustment were different from the procedures used in FY 2000-FY 2002. Blue Cross revised their procedures beginning in FY 2000 and began calculating this adjustment using actual costs captured by their accounting system. Blue Cross determined that this method would more accurately reflect any excess charges to Medicare for executive compensation. We agree that the new procedures put in place by Blue Cross would result in a more accurate adjustment for executive compensation. Using the new procedures, we determined that additional adjustments of \$64,051 should have been made for FY 1999.

Section 31.205-6(p) of the FAR governed executive compensation during FYs 1999 - 2002. This section of the FAR states:

...(1) Costs incurred after January 1, 1998, for compensation of a senior executive in excess of the benchmark compensation amount determined applicable for the contractor fiscal year by the Administrator, Office of Federal Procurement Policy (OFPP), under Section 39 of the OFPP Act (41 U.S.C. 435) are unallowable...(2)...(ii) Senior executive means — ... (1) The Chief Executive Officer (CEO) or any individual acting in a similar capacity at the contractor's headquarters; (B) The four most highly compensated

employees in management positions at the contractor's headquarters, other than the CEO;...

For FY 1999 through FY 2002, we compared the benchmark compensation amounts used by Blue Cross for the adjustment of executive compensation to the benchmark compensation amount set by OFPP. The benchmark amount set by OFPP increased for each year in our audit period. OFPP posted a memorandum to set forth the new benchmark amount for each year.

For example, the memorandum from OFPP concerning the 1999 benchmark compensation amount states:

...I have determined pursuant to the requirements of Section 39 that the benchmark compensation amount for contractor fiscal year 1999 is \$342,986. This benchmark compensation amount is to be used for contractor fiscal year 1999, and subsequent contractor fiscal years, unless and until revised by OFPP. This benchmark compensation amount applies to contract costs incurred after January 1, 1999...

Blue Cross made the executive compensation adjustment for FY 1999 by using \$342,986 as the benchmark. However, after discussions with OFPP we determined that since the benchmark amount applies to contract costs incurred after January 1, 1999, costs incurred prior to this date fall under the 1998 benchmark amount. Since Blue Cross reports costs on a fiscal year (October through September), the appropriate benchmark amount to be used for FY 1999 would be 25 percent of the benchmark set January 1, 1998 and 75 percent of the benchmark set January 1, 1999. The benchmark amount to be used for FY 1999 should have been \$342,402.

The following are the additional adjustments that would have been made: (1) if the appropriate benchmark amounts had been applied for FYs 1999 - 2002 (\$8,462), and (2) the revised executive compensation procedures were used in FY 1999 (\$64,051).

<u>Fiscal Year</u>	<u>Part A</u>	<u>Part B</u>	<u>Total</u>
1999	\$ 4,033	\$ 60,546	\$ 64,579
2000	251	2,027	2,278
2001	606	3,629	4,235
2002	<u>391</u>	<u>1,030</u>	<u>1,421</u>
Total	<u>\$ 5,281</u>	<u>\$ 67,232</u>	<u>\$ 72,513</u>

**Recommendation**

We recommend that Blue Cross make additional adjustments of \$72,513 to its cost proposals for FYs 1999 - 2002.

**Blue Cross Response**

Blue Cross disagreed with a portion of this recommendation. Blue Cross stated that the previously calculated adjustments were actually overstated due to the fact that the adjustments inappropriately included reductions of the administrative assistants' compensation as well as the

executives. Therefore, Blue Cross requests that the executive compensation adjustment be reduced from \$72,513 to \$55,136.

**OIG Comments**

Although Blue Cross provided additional documentation to support reducing the adjustment from \$72,513 to \$55,136, certain figures on the documentation could not be verified. Therefore, we continue to believe our recommendation is appropriate.

**TUITION COSTS**

Blue Cross reported \$27,151 in tuition charges that did not meet the specific Medicare requirement or were not specifically related to Medicare. Blue Cross charged all tuition costs to a corporate cost center, which was allocated to substantially all lines of business within the company, including Medicare operations. Even though the Medicare program does not benefit from all higher education classes taken, it received a portion of all tuition costs.

Per Section 31.201-4 of the FAR:

...a cost is allocable to a Government contract if it - (a) Is incurred specifically for the contract; (b) Benefits both contract and other work, and can be distributed to them in reasonable proportion to the benefits received;...

Since the above criteria was not met for these costs, we are questioning \$27,151 in tuition costs claimed on the cost proposal for FY 1999.

**Recommendation**

We recommend that Blue Cross make a financial adjustment of \$27,151 to the cost proposal for FY 1999.

**Blue Cross Response**

Blue Cross concurred with this recommendation.

**GENERAL CONTINGENCY COST- EMPLOYEE DENTAL BENEFITS**

Blue Cross included a general contingency reserve in the amount of \$7,036 for a dental program that was allocated to Medicare. Blue Cross officials were unaware that these costs were in the agreement.

Blue Cross - A Mutual Insurance Company (Carrier) and Blue Cross - Subsidiary Employee Groups (Group) entered into agreement to provide dental benefits to covered persons as certified eligible by Group under a financial relationship with Carrier, whereby Group will effectively pay the cost of claims, plus administrative expense, up to an aggregate maximum liability amount. The Group agreed to pay to the Carrier, expenses in the amount of 14.4 percent of paid dental claims for administration expense, general administrative expense, and general contingency.

Our review of the contingency reserve calculation showed that a general contingency factor of 0.6 percent was included in the general administrative expense. The intent of this general

contingency factor was to establish a reserve balance for all cost-plus groups and to cover possible non-payment of claims by the client. The general contingency factor is a contingency cost as defined by the FAR.

Section 31.205-7(a) defines a contingency as:

...a possible future event or condition arising from presently known or unknown causes, the outcome of which is indeterminable at the present time.

Furthermore, Section 31.205-7(b) of the FAR states:

Costs for contingencies are generally unallowable...

We believe that the contingency costs are unallowable and should not have been charged to Medicare. The table below provides a breakdown of the amount of unallowable general contingency dental cost for each year of the audit period.

<u>Year</u>	<u>General Contingency Factor</u>	<u>Part A</u>	<u>Part B</u>	<u>Total Unallowable General Contingency</u>
1999	0.6%	\$141	\$ 1,328	\$1,469
2000	0.6%	169	1,595	1,764
2001	0.6%	195	1,706	1,901
2002	0.6%	<u>324</u>	<u>1,578</u>	<u>1,902</u>
Total		<u>\$829</u>	<u>\$6,207</u>	<u>\$7,036</u>

**Recommendation**

We recommend that Blue Cross adjust its cost proposals by \$7,036 for these contingency costs.

**Blue Cross Response**

Blue Cross concurred with this recommendation.

**POST RETIREMENT HEALTH BENEFIT**

Blue Cross allocated post retirement health benefit cost to the cost proposal for FY 2002. Blue Cross discovered that this cost should not be allocated to Medicare. Blue Cross made an adjustment to remove the cost from the cost proposal, however, the entire balance was not removed and \$2,411 was allocated to Medicare. Blue Cross stated that the balance of \$2,411 was the result of an error and an adjustment would be made to remove the remaining balance from the cost proposal for FY 2002.

### **Recommendation**

We recommend that Blue Cross follow through with the adjustment for \$2,411 to remove the balance for post retirement health benefit cost from the cost proposal for FY 2002.

### **Blue Cross Response**

Blue Cross concurred with this recommendation.

### **SUPPLEMENTAL SAVINGS PLAN**

In FY 2002, Blue Cross billed Medicare for professional services rendered in connection with supplemental savings plan for \$2,323. The Supplemental Savings Plan is a non-qualified deferred compensation plan for a select group of highly compensated employees. Since the plan is a non-qualified fund, it is not allowed to be charged to Medicare.

FAR Section 31.201-6(a) provides that:

...Costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract. ... when an unallowable cost is incurred, its directly associated costs are also unallowable.

Since the plan is a non-qualified savings plan, then any cost incurred to administer it is unallowable. Therefore, we have questioned the total cost of \$2,323 charged on the FY 2002 cost proposal.

### **Recommendation**

We recommend that Blue Cross make a financial adjustment of \$2,323 to its FY 2002 cost proposal for the unallowable cost associated to Supplemental Savings Plan.

### **Blue Cross Response**

Blue Cross concurred with this recommendation.

## **OTHER MATTERS**

### **Contractor Information Requested by CMS**

CMS has requested comments concerning the following areas:

1. Interim Expenditure Reports (IERs) - To determine the accuracy of the IERs filed by Blue Cross, we reviewed the IERs and compared them to the submitted cost proposals and approved budget amounts. Our limited review did not disclose any material inaccuracies, inconsistencies, or weaknesses other than those included in the findings and recommendations section of this report.

2. Significant Data Processing Purchases/Leases - Blue Cross had three significant data processing purchases/lease contracts during the audit period. On July 7, 1998, Blue Cross signed a contract with Comdisco, Incorporated for the lease of regular business central processing unit for 36 months. The lease has a monthly cost of \$26,443 (including 23 months of maintenance) plus applicable sales taxes. This lease contract was for private business but some usage caused a small amount of costs to be allocated to Medicare business.

On August 31, 1999, Blue Cross signed a subcontract lease with Storagetek for a virtual storage manager to support the growth of additional Medicare claims processing business. The cost of the lease, including installation and the first year maintenance, is \$14,062 for 36 months. Additional maintenance costs of \$3,524 for 24 months will be covered under a separate subcontract. Medicare Part A will be allocated 100 percent of the hardware costs.

On September 25, 2000, Blue Cross entered into a subcontract with OCE Printing Systems USA, Inc, Xerox, Pitney Bowes, and Moore North America for the acquisitions of upgrading print and mail equipment. The total cost of this acquisition is \$3,186,098. Medicare will be allocated 68 percent of the mail equipment and 72 percent of the print equipment.

3. Complimentary Insurance Credits - To determine Blue Cross's compliance with complementary insurance financial policies, we included test work surrounding Blue Cross' compliance in this area as part of the scope of our audit. Through results of this test work, we concluded that Blue Cross had properly complied with the complementary insurance financial policies during the audit period.

### **Secondary Review of Data Entries**

During our review of indirect costs and allocation methods, we identified two instances where supporting documentation was in conflict with data entry information.

1. Cost of office supplies was allocated to a particular cost center when the invoice indicated a different cost center. This error resulted in more costs being charged to Medicare and reported on the cost proposal.
2. Statistical data was entered incorrectly and/or missing for a particular cost center. These errors cause more costs to be allocated to Medicare each time expense items were assigned to the cost center. The errors made in the statistical data were immaterial but the cumulative monetary effect to Medicare could become material over time.

Overall, the monetary effects were minimal for the items identified above and therefore immaterial for cost proposal purposes. However, we believe that procedures should be put into place and correctly followed to ensure that secondary review of data entries is performed so that the cost proposal receives the correct share of costs.

### **Blue Cross Response**

Blue Cross concurred, stating they are continuing to develop new procedures that allow for additional review and scrutiny of costs allocated to the Medicare program.

**EXHIBIT A**

**ARKANSAS BLUE CROSS BLUE SHIELD  
FINAL ADMINISTRATIVE COST PROPOSAL  
AND THE OIG RECOMMENDATIONS (Part A)  
FOR THE FISCAL YEAR 1999  
(OCTOBER 1998 - SEPTEMBER 1999)**

<b>Operation</b>	<b><u>Administrative Costs</u></b>
<b>Total Budget</b>	<b><u>Part A</u></b>
	<b><u>\$12,835,419</u></b>
<b>Costs Claimed:</b>	
Bills Payment	\$1,321,640
Appeals/Reviews	200,518
Inquiries	139,752
Prov Education and Training	138,109
Provider Reimbursement	388,361
Productivity Investments	8,122,569
Provider Telephone Inquiries	-
Credits	(161,651)
Medical Review	686,274
Medicare Secondary Payer	377,357
Benefit Integrity	59,142
MIP Provider Education and Training	32,792
Audit	1,502,356
MIP Special Projects	28,200
Non-Renewals-NJ BC Transition	-
<b>Total Administrative Costs Claimed</b>	<b><u>12,835,419</u></b>
<b>Recommended Adjustments:</b>	
Subcontract Costs	232
Related Party Transactions	47,217
Executive Compensation Costs	4,033
Tuition Costs	5,620
General Contingency-Employee Dental Benefits	141
Post Retirement Health Benefit	-
Supplemental Savings Plan	-
<b>Total Recommended Adjustments</b>	<b><u>57,243</u></b>
<b>Set Aside Costs:</b>	
Related Party Transactions	68,419
<b>Total Set Aside Costs</b>	<b><u>68,419</u></b>
<b>Total Costs Recommended for Acceptance</b>	<b><u>\$12,709,757</u></b>

**EXHIBIT B**

**ARKANSAS BLUE CROSS BLUE SHIELD  
FINAL ADMINISTRATIVE COST PROPOSAL  
AND THE OIG RECOMMENDATIONS (Part B)  
FOR THE FISCAL YEAR 1999  
(OCTOBER 1998 - SEPTEMBER 1999)**

<u>Operation</u>	<u>Administrative Costs</u>
<b>Total Budget</b>	<b>Part B</b>
	<u>\$44,322,773</u>
<b>Costs Claimed:</b>	
Claims Payment	27,116,799
Reviews and Hearings	3,527,491
Beneficiary/Phys Inquiry	6,072,895
Provider Ed and Training	1,373,535
Participating Physician	230,065
Productivity Investment	2,343,774
Special Projects	96
Credits-Complimentary	(6,496,240)
Medical Review	5,647,792
Medicare Secondary Payer	2,246,582
Benefit Integrity	1,826,244
MIP Provider Educ and Training	408,340
MIP Productivity Investments	22,114
MIP Special Projects	<u>3,286</u>
<b>Total Administrative Costs Claimed</b>	<u>44,322,773</u>
<b>Recommended Adjustments:</b>	
Subcontract Costs	1,584
Related Party Transactions	-
Executive Compensation Costs	60,546
Tuition Costs	21,531
General Contingency-Employee Dental Benefits	1,328
Post Retirement Health Benefit	-
Supplemental Savings Plan	<u>-</u>
<b>Total Recommended Adjustments</b>	<u>84,989</u>
<b>Set Aside Costs:</b>	
Related Party Transactions	-
<b>Total Set Aside Costs</b>	<u>-</u>
<b>Total Costs Recommended for Acceptance</b>	<u>\$44,237,784</u>

**EXHIBIT C**

**ARKANSAS BLUE CROSS BLUE SHIELD**  
**FINAL ADMINISTRATIVE COST PROPOSAL**  
**AND THE OIG RECOMMENDATIONS (Part A)**  
**FOR THE FISCAL YEAR 2000**  
**(OCTOBER 1999 - SEPTEMBER 2000)**

<b><u>Operation</u></b>	<b><u>Administrative Costs</u></b>
<b>Total Budget</b>	<b><u>Part A</u></b> <b><u>\$10,348,572</u></b>
<b>Costs Claimed:</b>	
Bills Payment	\$1,807,982
Appeals/Reviews	145,294
Inquiries	203,343
Prov Education and Training	137,148
Provider Reimbursement	320,247
Productivity Investments	5,013,910
Provider Telephone Inquiries	-
Credits	(182,514)
Medical Review	713,372
Medicare Secondary Payer	363,906
Benefit Integrity	86,551
MIP Provider Education and Training	40,738
Audit	1,685,595
MIP Special Projects	-
Non-Renewals-NJ BC Transition	<u>13,000</u>
<b>Total Administrative Costs Claimed</b>	<b><u>10,348,572</u></b>
<b>Recommended Adjustments:</b>	
Subcontract Costs	1,148
Related Party Transactions	-
Executive Compensation Costs	251
Tuition Costs	-
General Contingency-Employee Dental Benefits	169
Post Retirement Health Benefit	-
Supplemental Savings Plan	<u>-</u>
<b>Total Recommended Adjustments</b>	<b><u>1,568</u></b>
<b>Set Aside Costs:</b>	
Related Party Transactions	1,783
<b>Total Set Aside Costs</b>	<b><u>1,783</u></b>
<b>Total Costs Recommended for Acceptance</b>	<b><u>\$10,345,221</u></b>

**EXHIBIT D**

**ARKANSAS BLUE CROSS BLUE SHIELD  
FINAL ADMINISTRATIVE COST PROPOSAL  
AND THE OIG RECOMMENDATIONS (Part B)  
FOR THE FISCAL YEAR 2000  
(OCTOBER 1999 - SEPTEMBER 2000)**

<u>Operation</u>	<u>Administrative Costs</u>
<b>Total Budget</b>	<b><u>Part B</u></b>
	<b><u>\$49,737,254</u></b>
<b>Costs Claimed:</b>	
Claims Payment	\$31,378,130
Reviews and Hearings	3,649,851
Beneficiary/Phys Inquiry	6,180,521
Provider Ed and Training	1,779,110
Participating Physician	269,600
Productivity Investment	3,012,838
Special Projects	-
Credits-Complimentary	(7,795,394)
Medical Review	5,896,479
Medicare Secondary Payer	3,130,833
Benefit Integrity	1,778,864
MIP Provider Educ and Training	456,422
MIP Productivity Investments	-
MIP Special Projects	-
<b>Total Administrative Costs Claimed</b>	<b><u>49,737,254</u></b>
<b>Recommended Adjustments:</b>	
Subcontract Costs	96,645
Related Party Transactions	-
Executive Compensation Costs	2,027
Tuition Costs	-
General Contingency-Employee Dental Benefits	1,595
Post Retirement Health Benefit	-
Supplemental Savings Plan	-
<b>Total Recommended Adjustments</b>	<b><u>100,267</u></b>
<b>Set Aside Costs:</b>	
Related Party Transactions	-
<b>Total Set Aside Costs</b>	<b><u>-</u></b>
<b>Total Costs Recommended for Acceptance</b>	<b><u>\$49,636,987</u></b>

**EXHIBIT E**

**ARKANSAS BLUE CROSS BLUE SHIELD  
FINAL ADMINISTRATIVE COST PROPOSAL  
AND THE OIG RECOMMENDATIONS (Part A)  
FOR THE FISCAL YEAR 2001  
(OCTOBER 2000 - SEPTEMBER 2001)**

<b>Operation</b>	<b>Administrative Costs</b>
<b>Total Budget</b>	<b>Part A</b>
	<u>\$8,897,800</u>
<b>Costs Claimed:</b>	
Bills Payment	1,894,262
Appeals/Reviews	192,147
Inquiries	177,541
Prov Education and Training	171,233
Provider Reimbursement	433,871
Productivity Investments	2,652,604
Provider Telephone Inquiries	237,537
Credits	(198,716)
Medical Review	725,436
Medicare Secondary Payer	474,456
Benefit Integrity	110,586
MIP Provider Education and Training	55,304
Audit	1,694,085
MIP Special Projects	-
Non-Renewals-NJ BC Transition	<u>38,782</u>
<b>Total Administrative Costs Claimed</b>	<u>8,659,128</u>
<b>Recommended Adjustments:</b>	
Subcontract Costs	4,769
Related Party Transactions	-
Executive Compensation Costs	606
Tuition Costs	-
General Contingency-Employee Dental Benefits	195
Post Retirement Health Benefit	-
Supplemental Savings Plan	<u>-</u>
<b>Total Recommended Adjustments</b>	<u>5,570</u>
<b>Set Aside Costs:</b>	
Related Party Transactions	-
<b>Total Set Aside Costs</b>	<u>-</u>
<b>Total Costs Recommended for Acceptance</b>	<u>\$8,653,558</u>

**EXHIBIT F**

**ARKANSAS BLUE CROSS BLUE SHIELD  
FINAL ADMINISTRATIVE COST PROPOSAL  
AND THE OIG RECOMMENDATIONS (Part B)  
FOR THE FISCAL YEAR 2001  
(OCTOBER 2000 - SEPTEMBER 2001)**

<u>Operation</u>	<u>Administrative Costs</u>
<b>Total Budget</b>	<b>Part B</b>
	<u>\$50,409,800</u>
<b>Costs Claimed:</b>	
Claims Payment	33,069,552
Reviews and Hearings	4,189,428
Beneficiary/Phys Inquiry	4,089,985
Provider Ed and Training	1,637,890
Participating Physician	386,505
Productivity Investment	157,559
Provider Telephone Inquiries	2,275,890
Special Projects	-
Credits-Complimentary	(8,348,081)
Medical Review	5,815,081
Medicare Secondary Payer	3,001,653
Benefit Integrity	1,941,184
MIP Provider Educ and Training	688,566
MIP Productivity Investments	-
MIP Special Projects	554,833
<b>Total Administrative Costs Claimed</b>	<u>49,460,045</u>
<b>Recommended Adjustments:</b>	
Subcontract Costs	218,239
Related Party Transactions	-
Executive Compensation Costs	3,629
Tuition Costs	-
General Contingency-Employee Dental Benefits	1,706
Post Retirement Health Benefit	-
Supplemental Savings Plan	-
<b>Total Recommended Adjustments</b>	<u>223,574</u>
<b>Set Aside Costs:</b>	
Related Party Transactions	-
<b>Total Set Aside Costs</b>	<u>-</u>
<b>Total Costs Recommended for Acceptance</b>	<u>\$49,236,471</u>

**EXHIBIT G**

**ARKANSAS BLUE CROSS BLUE SHIELD  
FINAL ADMINISTRATIVE COST PROPOSAL  
AND THE OIG RECOMMENDATIONS (Part A)  
FOR THE FISCAL YEAR 2002  
(OCTOBER 2001 - SEPTEMBER 2002)**

<u>Operation</u>	<u>Administrative Costs</u>
<b>Total Budget</b>	<b>Part A</b>
	<u>\$7,460,900</u>
 <b>Costs Claimed:</b>	
Bills Payment	\$2,049,315
Appeals/Reviews	217,921
Inquiries	193,935
Prov Education and Training	128,075
Provider Reimbursement	457,464
Productivity Investments	1,429,389
Provider Telephone Inquiries	261,984
Credits	(237,559)
Medical Review	553,744
Medicare Secondary Payer	520,819
Benefit Integrity	112,465
MIP Provider Education and Training	42,591
Audit	1,646,874
MIP Special Projects	-
Non-Renewals-NJ BC Transition	-
<b>Total Administrative Costs Claimed</b>	<u>7,377,017</u>
 <b>Recommended Adjustments:</b>	
Subcontract Costs	878
Related Party Transactions	-
Executive Compensation Costs	391
Tuition Costs	-
General Contingency-Employee Dental Benefits	324
Post Retirement Health Benefit	-
Supplemental Savings Plan	<u>300</u>
<b>Total Recommended Adjustments</b>	<u>1,893</u>
 <b>Set Aside Costs:</b>	
Related Party Transactions	-
<b>Total Set Aside Costs</b>	-
 <b>Total Costs Recommended for Acceptance</b>	 <u>\$7,375,124</u>

**EXHIBIT H**

**ARKANSAS BLUE CROSS BLUE SHIELD  
FINAL ADMINISTRATIVE COST PROPOSAL  
AND THE OIG RECOMMENDATIONS (Part B)  
FOR THE FISCAL YEAR 2002  
(OCTOBER 2001 - SEPTEMBER 2002)**

<b>Operation</b>	<b><u>Administrative Costs</u></b>
<b>Total Budget</b>	<b><u>Part B</u></b>
	<b><u>\$52,302,000</u></b>
 <b>Costs Claimed:</b>	
Claims Payment	\$36,195,011
Reviews and Hearings	4,364,689
Beneficiary/Phys Inquiry	4,465,839
Provider Ed and Training	1,566,561
Participating Physician	444,842
Productivity Investment	838,817
Provider Telephone Inquiries	2,516,879
Special Projects	-
Credits-Complimentary	(9,888,664)
Medical Review	4,661,161
Medicare Secondary Payer	3,215,795
Benefit Integrity	2,128,112
MIP Provider Educ and Training	806,856
MIP Productivity Investments	-
MIP Special Projects	-
<b>Total Administrative Costs Claimed</b>	<b><u>51,315,898</u></b>
 <b>Recommended Adjustments:</b>	
Subcontract Costs	207,400
Related Party Transactions	-
Executive Compensation Costs	1,030
Tuition Costs	-
General Contingency-Employee Dental Benefits	1,578
Post Retirement Health Benefit	2,411
Supplemental Savings Plan	2,023
<b>Total Recommended Adjustments</b>	<b><u>214,442</u></b>
 <b>Set Aside Costs:</b>	
Related Party Transactions	-
<b>Total Set Aside Costs</b>	<b><u>-</u></b>
<b>Total Costs Recommended for Acceptance</b>	<b><u>\$51,101,456</u></b>



Arkansas  
BlueCross BlueShield

601 S. Gaines St.  
P.O. Box 2181  
Little Rock, Arkansas 72203-2181

September 26, 2003

Mr. Gordon L. Sato  
Regional Inspector General for Audit Services  
Department of Health & Human Services  
Office of Inspector General  
Office of Audit Services  
1100 Commerce, Room 632  
Dallas, TX 75242

Dear Mr. Sato:

Following are comments to the draft audit report concerning CIN A-06-03-00013. The draft report was referenced in your letter dated August 28, 2003.

We would first of all like to thank the Office of Inspector General staff for the work performed while they were at our plan. The OIG staff worked closely with the Arkansas Blue Cross and Blue Shield staff to obtain the information that was needed, and we were made aware of issues as they were identified. We appreciate the professional handling of this engagement.

The following findings have been identified:

- Subcontract costs totaling - \$530,895: These costs were allocated to Medicare over a four year period due to allocation error. ABCBS agrees with this adjustment.
- Related party costs of - \$47,217 / (\$70,202 set aside): Both the recommended adjustment and the amount set aside relate to ABCBS' share of expenses that were billed by the Arkansas Data Center for programming work – primarily related to Y2K. The recommended adjustments represent the differences between amounts billed by the Arkansas Data Center to users and the amounts paid by the Arkansas Data Center to USABLE Systems and contracted programmers. The set aside amount represents the difference between the amounts paid to USABLE Systems/contracted programmers and the actual staff costs as identified by OIG. These calculated actual staff costs do not represent total staff costs as they only include the gross salary. They do not include fringe benefits or other direct costs for those resources. Therefore, the actual cost in this calculation is understated.

Mr. Gordon L. Sato  
September 26, 2003  
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ABCBS does not agree with this adjustment. Y2K work of the Arkansas Data Center was billed to users of the ADC at a predetermined rate. The ADC contract with the users was not a cost contract during FY 1999. Therefore, no adjustment is due for this activity. This issue was addressed during the FY 1995 – 1998 FACP audit. The Arkansas Data Center (ADC) was begun in FY 1997 in response to an Invitation to Compete that was distributed by CMS. Within that Invitation to Compete, it indicated that the costs included in each operating agreement was to reflect the bid price accepted by the intermediary and approved by CMS and BCBSA for intermediaries who were subcontractors with BCBSA. Arkansas was selected as a vendor to provide these services to certain Part A Intermediaries. Although CMS selected ADC to participate, the contracts for these services were actually between ADC and the users. There is no contract between ADC and CMS. Therefore, CMS did not establish any oversight authority upon the ADC other than to act as a coordinator of activities between ADC and the users. Until mid-FY 2000 ADC had operated under the financial terms of the Invitation to Compete, i.e., through establishment of billing rates prior to the beginning of the upcoming fiscal year and billed for their services based upon those rates. The primary billing statistic used was the paid claim volume. Billings for special services were established during FY 1998 in response to the many requests from ADC users for special work. After the first quarter of FY 2000, BCBSA issued their recommendation that the ADC contract with its users be a “cost” contract. Essentially, BCBSA was indicating that the contract between ADC and the other BCBS plans represented an inter-company transaction from the global BCBS perspective. As such, FY 2000 was the first year that ADC had operated under the status of a cost contract (basically the IPOA). It would have been more beneficial to ADC to have operated under a cost contract since its inception. Actual cost and revenue for the first two years, 1997 being a partial fiscal year, were essentially the same – creating no material gain or loss for the ADC. However, FY 1999 operations resulted in a huge operating loss for the ADC - more than \$1.3 million for claims production and almost \$900,000 for all operations after consideration of special services.

Therefore, ABCBS disagrees with this finding based upon the terms of the Invitation to Compete and the understandings of billings between HCFA, BCBSA, ADC and the ADC users.

- Executive compensation - \$72,513: The draft adjustment amount represents additional disallowed amounts above the adjustments that Arkansas Blue Cross and Blue Shield previously made to executive compensation amounts. The majority of the adjustment was made to FY 1999 and is attributable primarily to application of a new ABCBS adjustment calculation methodology that OIG has endorsed. OIG adjustments to FY's 2000 – 2002 result from application of the allowable cap on a calendar year basis rather than a fiscal year basis.

Arkansas Blue Cross and Blue Shield discussed with OIG the fact that the previously calculated adjustments were actually overstated due to the fact that the adjustments included reductions of the administrative assistants' compensation as well as the

Mr. Gordon L. Sato  
September 26, 2003  
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executives. Therefore, we are requesting that the executive compensation adjustment be reduced from \$72,513 to \$55,136.

- Tuition - \$27,151: ABCBS calculated and agrees with this adjustment.
- Dental contingency reserve - \$7,036: ABCBS calculated and agrees with this adjustment.
- Post retirement health benefit - \$2,411: ABCBS agrees with this adjustment.
- Supplemental Savings Plan - \$2,323: ABCBS agrees with this adjustment.

In addition to the adjustments identified, CMS requested comments on "Other Matters" within the report. These were procedural items identified in the audit that resulted in immaterial impacts to the cost reports. Specifically, the report recommended that "procedures should be put into place and correctly followed to ensure that secondary review of data entries be performed so that the cost proposal receives the correct share of costs". In response to this, ABCBS continually strives to improve all of its processes, including invoice coding and review for accuracy of entry. ABCBS is continuing to develop new procedures that allow for additional review and scrutiny of costs allocated to the Medicare program. Some of these items were discussed with OIG staff during the audit. The tools that we are developing and utilizing increase our ability to identify clerical errors that occur from time to time due to the volume of transactions involved with the administration of the program. We will continue to invest in controls that strengthen our ability to accurately report costs to the program.

Thank you for the work of your staff during this review. Please feel free to contact me at 501-378-2250 if you need any additional information or clarification regarding this response.

Sincerely,



Dennis Robertson  
Sr. Vice President, Public Programs

CC:db

Attachment