

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE  
ADMINISTRATIVE COSTS CLAIMED BY  
BLUE CROSS AND BLUE SHIELD  
OF MONTANA  
HELENA, MONTANA**

**FOR THE PERIOD  
OCTOBER 1, 1997 TO SEPTEMBER 30, 1999**



**OCTOBER 2001  
A-07-01-02095**



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Office of Audit Services

Region VII  
601 East 12th Street  
Room 284A  
Kansas City, Missouri 64106

CIN: A-07-01-02095  
October 1, 2001

Mr. Mike Wagner  
Corporate Treasurer and Vice President  
of Government Programs  
Blue Cross Blue Shield of Montana  
404 Fuller Ave.  
Helena, Montana 56901

Dear Mr. Wagner:

Enclosed for your information are two copies of an audit report (CIN A-07-01-02095) prepared by Conrad and Associates, L.L.P. on behalf of the Department of Health and Human Services (HHS), Office of Inspector General (OIG), Office of Audit Services (OAS). The OAS exercised technical oversight and quality control on the examination.

The report covers the audit of administrative costs claimed by Blue Cross Blue Shield of Montana for Part A and Part B of the Medicare Program for the period October 1, 1997 through September 30, 1999. For the period audited, Blue Cross Blue Shield of Montana reported administrative costs of \$4,321,121 for Part A and \$6,606,700 for Part B. The auditors questioned \$211,086. Questioned costs included unallowable deferred compensation costs, excessive executive compensation, errors in the calculation of return on investment, and a lack of support for certain consultant costs. The auditors also noted material internal control deficiencies relating to insufficient documentation of the indirect cost allocation and errors in reporting costs incurred. Your attention is invited to the findings and recommendations contained in the report.

Final determinations as to actions to be taken on all matters reported will be made by the HHS action official named. In accordance with the principles of the Freedom of Information Act, (Public Law 90-23), OIG, OAS reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act, which the Department chooses to exercise. (See 45 Code of Federal Regulations, Part 5).

Mr. Wagner – Page 2

To facilitate identification, please refer to the above Common Identification Number (CIN) in all correspondence relating to this report.

Sincerely,

A handwritten signature in black ink, appearing to read "James P. Aasmundstad". The signature is fluid and cursive, with a prominent initial "J" and a long, sweeping underline.

James P. Aasmundstad  
Regional Inspector General  
for Audit Services

Enclosure

HHS Action Official

Mr. Alex Trujillo  
Regional Administrator  
Centers for Medicare and Medicaid Services  
1600 Broadway, Suite 700  
Denver, Colorado 80202

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Audit of Medicare Final  
Administrative Cost Proposals

For the Period  
October 1, 1997 through September 30, 1999

CONRAD AND  
ASSOCIATES, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

BLUE CROSS AND BLUE SHIELD  
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EXECUTIVE SUMMARY

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

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Executive Summary

Conrad and Associates, L.L.P., Certified Public Accountants, under contract with the U.S. Department of Health and Human Services (DHHS), has performed a financial and compliance audit of expenditures claimed by Blue Cross and Blue Shield of Montana (BCBS) related to administration of the Medicare Part A and Part B programs. The audit covered Final Administrative Cost Proposals (FACP's) for the Medicare program submitted by BCBS for the period of October 1, 1997 through September 30, 1999.

Our audit included such tests necessary to assure that costs charged to Medicare were allowable and allocable and were provided in an economic and efficient manner. Our audit efforts tested the allowability of those administrative costs as well as their allocability to the Medicare program using the Medicare agreements, the Federal Acquisition regulation (FAR), and appropriate cost accounting standards and generally accepted accounting standards as guiding criteria.

Results of Audit

For the period under audit, BCBS reported Medicare Part A program administrative costs of \$4,321,121 and Medicare Part B program administrative costs of \$6,606,700. Of these costs, we have questioned \$211,086 (\$60,259 Part A and \$150,827 Part B). For the period under audit, BCBS incurred Medicare Part A program administrative costs of \$5,161,643 and Medicare Part B program administrative costs of \$9,792,106. Total costs incurred by BCBS for Medicare Part A and Part B were more than total costs reported because BCBS reported costs only up to the amount that was included in the Approved Notice of Budget Authorization (NOBA) for the Medicare programs. The adjusted costs presented in Schedules A through D do not include as an offset the amounts allocated to the Programs but not claimed on the FACP's for FY's 1998 and 1999. CMS would be responsible for approving any offsets. The following is a summarization of our findings:

1. UNALLOWABLE DEFERRED COMPENSATION COSTS

BCBS did not reduce costs claimed for unfunded and non-qualified deferred compensation plan costs for FY 1998 that are non-deductible under IRS guidelines and accordingly unallowable under FAR Section 31.205-6-(b)-(2). BCBS had excluded these costs from its FY 1997 FACP. As a result, costs of \$39,074 and \$76,095 for Medicare Part A and Part B, respectively, are questioned.

2. EXCESSIVE EXECUTIVE COMPENSATION

BCBS included executive compensation in excess of the amount allowable per the Federal Register. Medicare Part A amounts questioned are \$997 and \$2,403 for FY's 1998 and 1999 respectively, and Medicare Part B amounts questioned are \$1,943 and \$5,405 for FY's 1998 and 1999, respectively.

3. RETURN ON INVESTMENT ERRORS

Errors were made in the calculation of return on investment (ROI) charges resulting in Medicare Part A questioned costs of \$5,064 and \$11,548 for FY's 1998 and 1999, respectively, and Medicare Part B questioned costs of \$18,623 and \$17,560 for FY's 1998 and 1999, respectively.

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4. LACK OF CONSULTING AGREEMENTS

BCBS was unable to provide consulting agreements to support certain consultant costs claimed. As a result, we have questioned costs in FY 1999 of \$1,173 for Medicare Part A and \$31,201 for Medicare Part B as unsupported. Unsupported costs are questioned because there is inadequate assurance they are allowable, allocable, reasonable and incurred for the benefit of the Medicare program.

5. ERRORS IN REPORTING COSTS INCURRED

BCBS incurred several errors in accumulating total costs incurred used in preparation of the FACP's that were never recognized or corrected due to the lack of an adequate review process.

6. INTERIM EXPENDITURE REPORTS PROCEDURES NOT ADEQUATE

Interim Expenditure Reports are prepared and submitted using budget amounts rather than actual expenditures.

7. INSUFFICIENT DOCUMENTATION OF INDIRECT COST ALLOCATION

BCBS did not provide sufficient and current supporting documentation to support all indirect cost allocation statistics.

A summary of the questioned costs for Medicare Parts A and B identified by finding is as follows:

<u>Finding Number</u>	<u>Part A</u>			<u>Part B</u>			<u>Total</u>
	<u>FY 98</u>	<u>FY 99</u>	<u>Sub Total</u>	<u>FY 98</u>	<u>FY 99</u>	<u>Sub Total</u>	
1	\$39,074	-	39,074	76,095	-	76,095	115,169
2	997	2,403	3,400	1,943	5,405	7,348	10,748
3	5,064	11,548	16,612	18,623	17,560	36,183	52,795
4	-	1,173	1,173	-	31,201	31,201	32,374
5	-	-	-	-	-	-	-
6	-	-	-	-	-	-	-
7	-	-	-	-	-	-	-
Total	<u>\$45,135</u>	<u>15,124</u>	<u>60,259</u>	<u>96,661</u>	<u>54,166</u>	<u>150,827</u>	<u>211,086</u>

For a complete discussion of these findings, refer to the Findings and Recommendations section of this report.

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We evaluated BCBS's system of significant internal accounting and administrative controls, and compliance with laws and regulations that can materially affect BCBS's financial statements. Based on our evaluation, except for the questioned costs noted above, we believe the FACP's submitted by BCBS fairly presented allowable Medicare program costs. However, our review of internal control over financial reporting identified certain reportable conditions that we believe are material weaknesses. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect BCBS's ability to record, process, summarize, and report financial data consistent with the assertions of management in the FACP. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by the employees in the normal course of performing there assigned functions. We believe the reportable conditions described in the Schedule of Findings and Recommendations identified as findings numbered 5 and 7 are material weaknesses.

Auditee's Response

A draft copy of the report was provided to BCBS. Their responses to the findings, where appropriate, have been included in the body of the report, and included in its entirety as Appendix A. Overall, the intermediary generally agreed with our findings and recommendations.

\* \* \* \* \*

CONTRACT DISCLOSURE STATEMENT

This report is made pursuant to Contract HHS-100-95-0023 with Conrad and Associates, L.L.P., Certified Public Accountants, 1100 Main Street, Suite C, Irvine, California 92614. Certain information contained herein is subject to disclosure under the Freedom of Information Act, 5 U.S.C. 522(b)(4). The task Coordinator was Mr. Richard Warczynski, Centers for Medicare and Medicaid Services, 7500 Security Boulevard, Baltimore, Maryland 21244

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Acronyms

BCBS	Blue Cross and Blue Shield of Montana
DHHS	U.S. Department of Health and Human Services
FACP	Final Administrative Cost Proposal
FAR	Federal Acquisition Regulation
FY	Fiscal Year
CMS	Centers for Medicare and Medicaid Services
NOBA	Notice of Budget Authorization
OIG	Office of Inspector General, U.S. Department of Health and Human Services

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Introduction and Background

Health Insurance for the Aged and Disabled (Medicare), Title XVIII of the Social Security Act, provides for a hospital insurance program (Part A) and a related supplementary medical insurance program (Part B).

The Centers for Medicare and Medicaid Services (CMS), within the U.S. Department of Health and Human Services (DHHS), administers the Medicare program. Title XVIII provides, however, that public or private organizations (known as "intermediaries" for Medicare Part A and "carriers" for Medicare Part B) may assist in the program's administration.

Agreements with the intermediaries and carriers define the functions to be performed and provide for the reimbursement of allowable administrative costs incurred in their performance. Each participating intermediary and carrier (contractor) submits a prospective budget of administrative costs to be incurred during the Government fiscal year to the CMS Regional Office for review and approval. Following the close of each fiscal year, a final administrative cost proposal (FACP) is submitted, reporting the costs of performing Medicare functions incurred during the year. This cost proposal and supporting data serve as the basis for final settlement of allowable administrative costs.

After audit of the cost proposals, the contractor and CMS negotiate a final settlement.

BCBS was paid its costs for administration of the Medicare contracts under the principle of neither profit nor loss. Appendix B of the contracts and referenced federal regulations identified allowable administrative costs that could be reimbursed. Included in the administrative costs claimed for reimbursement are costs for general and administrative expenses attributable to the general management, supervision, and conduct of a contractor's business as a whole.

The Medicare Agreement states "...costs allowable and allocable under this agreement shall be determined in accordance with the provisions of Part 31 of the Federal Acquisition Regulation (FAR), as interpreted and modified by Appendix B of the agreement."

Section 31.201 of the FAR defines the total cost of a contract as the sum of the allowable direct and indirect costs allocable to a contract, incurred or to be incurred, less any applicable credits. The regulations also state that items of cost are allowable charges if they meet tests of reasonableness and allocability and if generally accepted accounting principles are followed.

A reasonable cost is defined as one that would be incurred by an ordinary prudent person in the conduct of a competitive business. Further, a cost is allocable if it is assignable or chargeable to a particular cost objective in reasonable proportion to the benefits received.

This report details the results of our audit of the FACP's submitted by BCBS to CMS for the period October 1, 1997 through September 30, 1999.

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Audit of Medicare Final Administrative Cost Proposals

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Objectives and Scope of Audit

Our audit of the FACP's submitted by BCBS for the fiscal years (FYs) ended September 30, 1998 and 1999, was made in accordance with generally accepted auditing standards and the standards for financial audits contained in the *Government Auditing Standards* as revised in 1999 and issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the FACP's are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the FACP's. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the FACP's. We believe that our audit provides a reasonable basis for our opinion.

The U.S. Department of Health and Human Services' (DHHS) Audit Guide for the Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers under Title XVIII of the Social Security Act (February 1991 revision) and other appropriate guidelines and instructions were used as guides in the audit.

Our audit included such tests necessary to assure that costs charged to Medicare were allowable and allocable and were provided in an economic and efficient manner. Our audit efforts tested the allowability of those administrative costs as well as their allocability to the Medicare program using the Medicare agreements, the Federal Acquisition Regulation (FAR), and appropriate cost accounting standards and generally accepted accounting standards as guiding criteria.

The audit was performed to provide CMS with sufficient data to close out the FACP's and determine if controls were adequate for administration of the Medicare program. The scope of the audit included costs for the year 2000 remediation, which were included in the total costs incurred.

An entrance conference was held on April 24, 2001 with BCBS in Helena, Montana. Fieldwork was performed during the period of April 24, 2001 through May 25, 2001 at BCBS's office in Helena, Montana. A preliminary exit conference was held with BCBS representatives in Helena, Montana on May 25, 2001 to discuss the results of our audit and request that additional information be sent to our office to complete our audit procedures. A final exit conference was conducted telephonically with BCBS representatives on July 30, 2001.

Administrative costs reported and claimed for each of the periods under audit were as follows:

	<u>Part A</u>	<u>Part B</u>
Fiscal year ended September 30, 1998	\$2,073,152	2,955,500
Fiscal year ended September 30, 1999	<u>2,247,969</u>	<u>3,651,200</u>
Total	<u>\$4,321,121</u>	<u>6,606,700</u>

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Objectives and Scope of Audit, (Continued)

Administrative cost incurred for each of the periods under audit were as follows:

	<u>Part A</u>	<u>Part B</u>
Fiscal year ended September 30, 1998	\$2,361,909	4,537,426
Fiscal year ended September 30, 1999	<u>2,799,734</u>	<u>5,254,680</u>
Total	<u>\$5,161,643</u>	<u>9,792,106</u>

Total costs incurred by BCBS for Medicare Part A and Part B were more than total costs reported because BCBS reported costs only up to the amount that was included in the Approved Notice of Budget Authorization (NOBA) for the Medicare programs. The adjusted costs presented in Schedules A through D do not include as an offset the amounts allocated to the Programs but not claimed on the FACP's for FY's 1998 and 1999. CMS would be responsible for approving any offsets.

The specific objectives of our audit were to:

1. Determine whether BCBS had established an effective system of internal control, accounting, and reporting for administrative costs incurred under the program.
2. Ascertain whether the FACP's present fairly the cost of program administration allowable in accordance with FAR, Title 48, Chapter 1, Part 31 as interpreted and modified by the Medicare agreements.
3. Ascertain whether BCBS has complied with contractual and administrative requirements governing specific items of cost.
4. Identify the underlying causes of significant errors or problems noted and make recommendations for improvement or adjustment of costs claimed as appropriate.

To meet the above stated objectives, our audit included a study of those internal control procedures of BCBS to the extent we considered necessary to evaluate the system and determine specific compliance therewith. In addition, we performed tests of specific costs to determine that BCBS complied with contractual and administrative requirements. All significant items noted during our audit are discussed in the Findings and Recommendations section of this report. Our Independent Auditors' Report on Medicare Final Administrative Cost Proposals and our Report on Compliance and On Internal Control Over Financial Reporting Based on an Audit of Final Administrative Cost Proposals Performed in Accordance with Government Auditing Standards are included in the Auditors' Reports section of this report.

During our audit we used judgmental sampling techniques for the purpose of determining the audit sample sizes. Our samples were designed to be representative and adequate for the purpose of expressing an opinion on the FACP's and included tests of wages, non-personnel costs, cost allocation policies and procedures, as well as specific tests for unallowable costs. Findings included in this report have been based solely upon our sample results.

AUDITORS' REPORTS

U.S. Department of Health and Human Services  
Centers for Medicare and Medicaid Services

**INDEPENDENT AUDITORS' REPORT ON  
MEDICARE FINAL ADMINISTRATIVE COST PROPOSALS**

We have audited the Final Administrative Cost Proposals (FACP's) (Schedules A through D) of Blue Cross and Blue Shield of Montana (BCBS) for the fiscal years ended September 30, 1999 and 1998. The amounts reported in the FACP's are the responsibility of BCBS's management. Our responsibility is to express an opinion on the FACP's based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the FACP's are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts claimed on the FACP's. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the FACP's. We believe that our audit provides a reasonable basis for our opinion.

The accompanying schedules were prepared in accordance with the instructions of the U.S. Department of Health and Human Services and reflect only administrative costs reported for operating the Medicare, Part A and Part B programs. Accordingly, the accompanying schedules are not intended to present financial position or results of operations in conformity with generally accepted accounting principles.

In our opinion, subject to the ultimate resolution of the \$211,086 of questioned costs identified in this report, the FACP's present fairly the costs of allowable program administration for the fiscal years ended September 30, 1999 and 1998 in accordance with the Federal Acquisition Regulation, Title 48, Chapter 1, Part 31, as interpreted and modified by the Medicare agreements.

This report is intended solely for the information and use of BCBS, U.S. Department of Health and Human Services, Office of Inspector General, and Centers for Medicare and Medicaid Services and is not intended to be and should not be used by anyone other than these specified parties.

*Conrad And Associates, L.L.P.*

May 25, 2001

U.S. Department of Health and Human Services  
Centers for Medicare and Medicaid Services

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING BASED ON AN AUDIT OF FINAL ADMINISTRATIVE  
COST PROPOSALS PERFORMED IN ACCORDANCE WITH  
*GOVERNMENT AUDITING STANDARDS*

We have audited the Final Administrative Cost Proposals (FACP's) (Schedules A through D) of Blue Cross and Blue Shield of Montana (BCBS) for the fiscal years ended September 30, 1999 and 1998 and have issued our report thereon dated May 25, 2001. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether BCBS's Final Administrative Cost Proposals are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of FACP amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*. These instances are described in the accompanying Schedule of Findings and Recommendations.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered BCBS's internal controls over reporting of the FACP's in order to determine our auditing procedures for the purpose of expressing our opinion on the FACP's and not to provide assurance on the internal control over FACP reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect BCBS's ability to record, process, summarize, and report financial data consistent with the assertions of management in the FACP. Reportable conditions noted and the resultant questioned costs are described in the accompanying Schedule of Findings and Recommendations.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by the employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. We believe the reportable conditions described in the Schedule of Findings and Recommendations identified as findings numbered 5 and 7 are material weaknesses.

U.S. Department of Health and Human Services  
Centers for Medicare and Medicaid Services  
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This report is intended solely for the information and use of BCBS, U.S. Department of Health and Human Services, Office of Inspector General, and the Centers for Medicare and Medicaid Services and is not intended to be and should not be used by anyone other than these specified parties.

*Leonard And Associates, L.L.P.*

May 25, 2001

FINDINGS AND RECOMMENDATIONS

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Audit of Medicare Final Administrative Cost Proposals

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Findings and Recommendations

1. Unallowable Deferred Compensation Costs

During our review of deferred compensation, we noted that BCBS had an unfunded and non-qualified deferred compensation plan, which is non-deductible under IRS regulations. The cost of the deferred compensation plan was not included in the non-Medicare adjustment for FY 1998 as it had been in FY 1997. As a result, the cost of the non-qualified deferred compensation plan was included in the costs charged to Medicare. The total cost of the deferred compensation plan for FY 1998 was \$855,000. The amount allocated to Medicare Part A was \$39,074, while the amount charged to Medicare Part B was \$76,095.

FAR Section 31.205-6 Compensation for personal services...(b) Reasonableness (2) states; "Compensation costs under certain conditions gives rise to the need for special consideration. Among such conditions are the following:...(iv) The contractor incurs costs for compensation in excess of the amounts which are deductible under the Internal Revenue Code and regulations issued under it."

Recommendation

We recommend that BCBS exclude \$39,074 and \$76,095 from the FY 1998 Medicare Part A and Part B FACP's, respectively, consistent with the interpretation of the FAR and BCBS's prior handling of those costs in the preparation of the FACP.

Auditee Response

We agree that our deferred compensation plan should not be allocated to Medicare per the Federal Acquisition Regulation. We have on our ledger two line items that account for this plan. In the preparation of the FACP for FY1998, one of the line items was included in the non-Medicare adjustment but one of them was missed resulting in an over allocation to Medicare. We concur with this finding and will not charge these expenses to Medicare on future FACP's.

Auditor Comment

We concur with the corrective actions proposed by BCBS.

2. Excessive Executive Compensation

In fiscal years 1998 and 1999 BCBS included executive compensation in excess of the amount allowable per the Federal Register. Of the excessive compensation costs identified, \$997 and \$2,403 for FY's 1998 and 1999, respectively, were allocated to Medicare Part A while \$1,943 and \$5,405 for FY's 1998 and 1999, respectively, were allocated to Medicare Part B.

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Findings and Recommendations. (Continued)

2. Excessive Executive Compensation. (Continued)

Recommendation

We recommend that BCBS exclude \$997 and \$2,403 for FY's 1998 and 1999, respectively, from the Medicare Part A FACP's. We also recommend that BCBS exclude \$1,943 and \$5,405 for FY's 1998 and 1999, respectively, from the Medicare Part B FACP's.

Auditee Response

We agree that this adjustment was missed when the FACP's for both fiscal years 1998 and 1999 were prepared. We concur with this finding and will include this adjustment on future preparations of the FACP's.

Auditor Comment

We concur with the corrective actions proposed by BCBS.

3. Return on Investment Errors

Our review of return on investment (ROI) charges for FY's 1998 and 1999 disclosed that BCBS overcharged Medicare due to errors made in the calculation of ROI. BCBS used the incorrect asset book values in some instances, and also incorrectly calculated the ROI rates. Errors made resulted in overcharges of \$5,064 and \$11,548 for FY's 1998 and 1999, respectively, for Medicare Part A, and \$18,623 and \$17,560 for FY's 1998 and 1999, respectively, for Medicare Part B.

Recommendation

We recommend that BCBS exclude \$5,064 and \$11,548 for FY's 1998 and 1999, respectively, from the Medicare Part A FACP's. We also recommend that BCBS exclude \$18,623 and \$17,560 for FY's 1998 and 1999, respectively, from the Medicare Part B FACP'S. In addition, we recommend that an employee other than the preparer review the ROI calculation prior to including it in the FACP.

Auditee Response

We agree that there were errors made in the calculation of Return on Investment (ROI). Procedures documenting the sources and methods needed to prepare the ROI have been put in place to avoid these errors in the future. It is also recognized that management review is needed and will be done on a routine basis in the future. We concur with the finding as stated.

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Findings and Recommendations, (Continued)

3. Return on Investment Errors. (Continued)

Auditor Comment

We concur with the corrective actions proposed by BCBS.

4. Lack of Consulting Agreements

BCBS was unable to locate and provide consulting agreements to support six separate charges for consulting services included in our sample for FY 1999. Without the consulting agreements we were unable to determine if the costs were reasonable and in accordance with the terms of the agreement. Accordingly, we have questioned \$1,173 of Medicare Part A and \$31,201 of Medicare Part B costs charged to the FACP's for FY 1999.

FAR Section 31.201-2(d) states in part; "A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles...The contracting officer may disallow all or part of a claimed cost which is inadequately supported."

Recommendation

We recommend that BCBS exclude \$1,173 and \$31,201 from the Medicare Part A and Part B FACP's, respectively, for FY 1999. In addition, we recommend that procedures be established to verify that all consulting expenses be supported by a consulting agreement and that the agreements are retained and readily accessible.

Auditee Response

We have recognized the need to have better corporate control over consulting agreements made by Blue Cross Blue Shield of Montana. As such, a task group has been formed to improve the contracting and inventory process of consulting agreements made throughout the corporation including the Medicare Program. As such, this finding should be avoided in the future.

Even though we were unable to locate the agreements in question, we still feel that the charges made to the Medicare Program represent valid Medicare costs and should be included in allowable costs. However, since the FAR Section 31.205-33(c) states that "services performed under any of the following circumstances are unallowable...(8) Adequacy of the contractual agreements for the service..." we concur with the adjustment as stated.

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Audit of Medicare Final Administrative Cost Proposals

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Findings and Recommendations. (Continued)

4. Lack of Consulting Agreements. (Continued)

Auditor Comment

We concur with the corrective actions proposed by BCBS.

5. Errors in Reporting Costs Incurred

We noted several errors made in accumulating total costs incurred used in preparation of the FACP's. BCBS accumulated costs by means of a Medicare A & B Allocations spreadsheet. Numerous costs were incorrectly transferred from the financial records to the spreadsheet. Also, there were errors within the spreadsheet in accumulating total costs. In addition, there were errors made within the crosswalk used to adjust total costs incurred to the amounts reported on the FACP's. Errors noted resulted in the following adjustments:

	1998		1999		Total
	A	B	A	B	
Medicare incurred costs per BCBS worksheets	\$3,615,579	7,304,487	2,993,808	5,355,661	19,269,535
Corrected costs	<u>2,361,909</u>	<u>4,537,426</u>	<u>2,799,734</u>	<u>5,254,680</u>	<u>14,953,749</u>
Adjustments	<u>\$1,253,670</u>	<u>2,767,061</u>	<u>194,074</u>	<u>100,981</u>	<u>4,315,786</u>

The errors appear to be the result of the fact that no one other than the preparer of the FACP was reviewing the various subsidiary schedules used in the preparation of the FACP. Because BCBS only reported costs up to the amount of the Approved Notice of Budget Authorization (NOBA) for the Medicare program, the adjustments noted above did not result in any questioned costs.

Recommendation

We recommend that a responsible employee other than the preparer of the FACP review the worksheets and schedules used in the preparation of the FACP's prior to submission to CMS.

Auditee Response

We agree that someone other than the preparer of the FACP's should review the worksheets and schedules used in the preparation of the FACP's. We have already put procedures in place to have management review the FACP's prior to final submission to CMS.

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Audit of Medicare Final Administrative Cost Proposals

For the Period  
October 1, 1997 through September 30, 1999

Findings and Recommendations. (Continued)

5. Errors in Reporting Costs Incurred. (Continued)

Auditor Comment

We concur with the corrective actions proposed by BCBS.

6. Interim Expenditure Reports Procedures Not Adequate

Our review of the Interim Expenditure Reports (IER's) revealed that the reports are not based on actual costs. The IER's are prepared by allocating the budget amount per NOBA to the period covered by the IER. We believe the IER's should be prepared on an actual cost incurred basis in accordance with requirements of Sections 1200 and 1300 of Part A of the Intermediary Fiscal Administrative Manual. Therefore, our tests disclosed that the methods and procedures used to report Medicare administrative costs on the IER's were not adequate.

Recommendation

We recommend that procedures be established to report actual expenditures on the Interim Expenditure Reports.

Auditee Response

We agree that our current method of preparing the Interim Expenditure Reports (IER) based on estimates is not adequate. This process of estimating arose due to the timing differences with the closing of the General Ledger and the due date of the IER. We recognize that a better method needs to be developed to report actual costs and options are presently being reviewed to accomplish this purpose.

Auditor Comment

We concur with the corrective actions being undertaken by BCBS.

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Audit of Medicare Final Administrative Cost Proposals

For the Period  
October 1, 1997 through September 30, 1999

Findings and Recommendations, (Continued)

7. Insufficient Documentation of Indirect Cost Allocation

BCBS did not retain sufficient supporting documentation for all indirect cost allocation statistics. For example, time studies used to allocate costs to different tasks were based on estimates by the head of the cost center of the time spent in each area and interviews within the department, however no documentation to support this was retained. In addition, BCBS was unable to provide support and we were unable to verify the total claims used to develop the percentages used for the claims statistics. Finally, many of the allocation statistics used to allocate overhead costs have not been updated since June 30, 1998.

FAR Section 31.201-2(d) states in part; "A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles. The contracting officer may disallow all or part of a claimed costs which is inadequately supported."

Recommendation

We recommend that procedures be established to ensure that statistics used in the allocation of indirect overhead costs be adequately documented and retained for review. We also recommend that all statistics be updated periodically.

Auditee Response

We concur that procedures need to be established to ensure that statistics used in the allocation of indirect overhead costs be timely, adequately documented, and retained for review. We have already put into place several changes to our processes including the centralization of supporting documents, changing our allocation system to allow for a narrative field to detail persons interviewed and allocation changes made, and to develop a schedule for future updates to the allocations. Most all cost allocations are presently being reviewed and will be updated by September 30, 2001.

Auditor Comment

We concur with the corrective actions undertaken and proposed by BCBS.

OTHER MATTERS

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Audit of Medicare Final Administrative Cost Proposals

For the Period  
October 1, 1997 through September 30, 1999

Other Matters

1. Resolution of Prior Audit Findings

There are no prior audit findings.

2. Interim Expenditure Reports

As part of our audit, we performed a limited review to ascertain the accuracy of BCBS's Interim Expenditure Reports. Our review was limited to a review of methods and procedures followed by BCBS in developing expenditures reports.

Our tests disclosed that the methods and procedures used to report Medicare administrative costs on the Interim Expenditure Reports were not adequate. See finding number 6 in the Findings and Recommendations section of this report.

3. Data Processing Costs

Other than for year 2000 (Y2K) remediation, BCBS did not incur any significant costs for planning, development or modification of the Medicare claims processing system during the audit period.

4. Complementary Insurance Credits

As part of our audit, we performed tests on the reported complementary insurance credits and ascertained that adequate procedures were being followed to ensure compliance with the Medicare contract.

5. Year 2000 Remediation Costs

As part of our audit, we performed tests of year 2000 remediation costs included in the total costs incurred by BCBS.

6. Costs Submitted in Excess of Incurred Costs for Certain Cost Categories

BCBS claimed costs on the FACP Cost Classification Report for Medicare Part A for FY 1998 that were in excess of the actual incurred costs for three cost categories. This was due primarily to the initial reported incurred costs being overstated prior to the audit adjustments. Excess costs submitted were as follows:

	<u>Costs Submitted</u>	<u>Adjusted Costs Incurred</u>	<u>Excess</u>
Fringe Benefits	\$403,500	366,096	37,404
EDP Equipment	19,200	14,171	5,029
Outside Professional Services	<u>106,452</u>	<u>68,495</u>	<u>37,957</u>
Total	<u>\$529,152</u>	<u>448,762</u>	<u>80,390</u>

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Audit of Medicare Final Administrative Cost Proposals

For the Period  
October 1, 1997 through September 30, 1999

Other Matters. (Continued)

No costs were questioned as total costs submitted by BCBS were equal to or less than the amount approved by the NOBA. In addition, it should be noted that BCBS incurred allowable costs in other categories that were not claimed which could be submitted to replace these excess costs.

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Schedule of Final Administrative Cost Proposals by Cost Classification - Part A

For the Period October 1, 1997 through September 30, 1998

<u>Category</u>	Reported Costs <u>Incurred</u>	Audit <u>Adjustments</u>	Adjusted Costs <u>Incurred</u>	Costs <u>Submitted</u>	Questioned <u>Costs</u>	Adjusted <u>Costs</u>
Salaries and wages	\$1,536,621	(532,810)	1,003,811	953,200	(997)	952,203
Fringe benefits	560,415	(194,319)	366,096	403,500	(39,074)	364,426
Facilities or occupancy	235,013	(81,489)	153,524	101,500	-	101,500
Electronic data processing equipment	21,693	(7,522)	14,171	19,200	-	19,200
Subcontracts	57,849	(20,058)	37,791	-	-	-
Outside professional services	104,852	(36,357)	68,495	106,452	-	106,452
Telephone and telegraph	108,467	(37,610)	70,857	46,500	-	46,500
Postage and express	314,555	(109,069)	205,486	136,100	-	136,100
Furniture and equipment (Non EDP)	169,932	(58,922)	111,010	72,900	-	72,900
Materials and supplies	141,008	(48,894)	92,114	61,100	-	61,100
Travel	144,623	(50,144)	94,479	63,600	-	63,600
Return on investment	108,467	(37,610)	70,857	63,100	(5,064)	58,036
Miscellaneous	112,084	(38,866)	73,218	46,000	-	46,000
Totals	<u>\$3,615,579</u>	<u>(1,253,670)</u>	<u>2,361,909</u>	<u>2,073,152</u>	<u>(45,135)</u>	<u>2,028,017</u>

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Schedule of Final Administrative Cost Proposals by Cost Classification - Part B

For the Period October 1, 1997 through September 30, 1998

<u>Category</u>	Reported Costs <u>Incurred</u>	Audit Adjustments	Adjusted Costs <u>Incurred</u>	Costs <u>Submitted</u>	Questioned Costs	Adjusted Costs
Salaries and wages	\$2,629,331	(935,266)	1,694,065	1,272,900	(1,943)	1,270,957
Fringe benefits	1,112,409	(395,689)	716,720	542,400	(76,095)	466,305
Facilities or occupancy	544,536	(193,694)	350,842	267,000	-	267,000
Electronic data processing equipment	435,629	(154,956)	280,673	1,000	-	1,000
Subcontracts	311,163	(110,682)	200,481	-	-	-
Outside professional services	241,152	(85,779)	155,373	118,400	-	118,400
Telephone and telegraph	248,931	(88,546)	160,385	122,400	-	122,400
Postage and express	731,234	(260,104)	471,130	358,100	-	358,100
Furniture and equipment (Non EDP)	388,954	(138,353)	250,601	191,700	-	191,700
Materials and supplies	326,722	(116,217)	210,505	160,700	-	160,700
Travel	342,280	(121,751)	220,529	167,300	-	167,300
Return on investment	217,814	(77,477)	140,337	107,300	(18,623)	88,677
Miscellaneous	248,932	(88,547)	160,385	120,900	-	120,900
Credits	(474,600)	-	(474,600)	(474,600)	-	(474,600)
Totals	<u>\$7,304,487</u>	<u>(2,767,061)</u>	<u>4,537,426</u>	<u>2,955,500</u>	<u>(96,661)</u>	<u>2,858,839</u>

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Schedule of Final Administrative Cost Proposals by Cost Classification - Part A

For the Period October 1, 1998 through September 30, 1999

<u>Category</u>	Reported Costs <u>Incurred</u>	Audit <u>Adjustments</u>	Adjusted Costs <u>Incurred</u>	Costs <u>Submitted</u>	Questioned <u>Costs</u>	Adjusted <u>Costs</u>
Salaries and wages	\$1,272,366	(82,479)	1,189,887	950,500	(2,403)	948,097
Fringe benefits	464,039	(30,080)	433,959	347,100	-	347,100
Facilities or occupancy	194,597	(12,614)	181,983	145,200	-	145,200
Electronic data processing equipment	17,963	(1,165)	16,798	13,900	-	13,900
Subcontracts	47,901	(3,105)	44,796	35,800	-	35,800
Outside professional services	86,820	(5,628)	81,192	78,380	(1,173)	77,207
Telephone and telegraph	89,814	(5,822)	83,992	66,600	-	66,600
Postage and express	260,461	(16,884)	243,577	194,800	-	194,800
Furniture and equipment (Non EDP)	140,709	(9,122)	131,587	104,200	-	104,200
Materials and supplies	116,758	(7,568)	109,190	87,400	-	87,400
Travel	119,752	(7,763)	111,989	91,000	-	91,000
Return on investment	89,814	(5,822)	83,992	67,389	(11,548)	55,841
Miscellaneous	92,814	(6,022)	86,792	65,700	-	65,700
Totals	<u>\$2,993,808</u>	<u>(194,074)</u>	<u>2,799,734</u>	<u>2,247,969</u>	<u>(15,124)</u>	<u>2,232,845</u>

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Schedule of Final Administrative Cost Proposals by Cost Classification - Part B

For the Period October 1, 1998 through September 30, 1999

<u>Category</u>	Reported Costs <u>Incurred</u>	Audit Adjustments	Adjusted Costs <u>Incurred</u>	Costs <u>Submitted</u>	Questioned Costs	Adjusted Costs
Salaries and wages	\$1,991,922	(34,131)	1,957,791	1,418,200	(5,405)	1,412,795
Fringe benefits	842,736	(14,440)	828,296	599,400	-	599,400
Facilities or occupancy	412,528	(7,068)	405,460	294,100	-	294,100
Electronic data processing equipment	330,023	(5,655)	324,368	234,400	-	234,400
Subcontracts	235,730	(4,039)	231,691	164,500	-	164,500
Outside professional services	182,691	(3,130)	179,561	130,400	(31,201)	99,199
Telephone and telegraph	188,584	(3,231)	185,353	134,800	-	134,800
Postage and express	553,967	(9,493)	544,474	394,500	-	394,500
Furniture and equipment (Non EDP)	294,663	(5,049)	289,614	211,100	-	211,100
Materials and supplies	247,517	(4,241)	243,276	177,100	-	177,100
Travel	259,303	(4,443)	254,860	184,300	-	184,300
Return on investment	165,011	(2,827)	162,184	112,727	(17,560)	95,167
Miscellaneous	188,586	(3,234)	185,352	133,273	-	133,273
Credits	(537,600)	-	(537,600)	(537,600)	-	(537,600)
<b>Totals</b>	<b><u>\$5,355,661</u></b>	<b><u>(100,981)</u></b>	<b><u>5,254,680</u></b>	<b><u>3,651,200</u></b>	<b><u>(54,166)</u></b>	<b><u>3,597,034</u></b>

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Final Administrative Cost Proposal - Part A

For the Period October 1, 1997 through September 30, 1998

<u>Operation</u>	<u>Budget Authorization</u>	<u>Administrative Costs Claimed</u>	<u>Variance- Favorable (Unfavorable)</u>
Bills/Claims Payment	\$ 549,352	549,352	-
Appeals/Reviews	45,100	45,100	-
Inquiries	73,900	73,900	-
Reimbursement	182,000	182,000	-
Productivity Investment	222,000	222,000	-
PM Special Projects	3,000	3,000	-
	<hr/>	<hr/>	
Subtotal - program management	1,075,352	1,075,352	-
	<hr/>	<hr/>	
Medical Review	141,000	141,000	-
Medicare Secondary Payer	140,700	140,700	-
Benefits Integrity	20,000	20,000	-
Provider Education and Training	6,300	6,300	-
Audit	689,800	689,800	-
	<hr/>	<hr/>	
Subtotal - medicare integrity	997,800	997,800	-
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Totals	\$ 2,073,152	2,073,152	-
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BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Final Administrative Cost Proposal - Part B

For the Period October 1, 1997 through September 30, 1998

<u>Operation</u>	<u>Budget Authorization</u>	<u>Administrative Costs Claimed</u>	<u>Variance- Favorable (Unfavorable)</u>
Bills/Claims Payment	\$ 1,670,200	1,740,200	(70,000)
Appeals/Reviews	102,000	119,400	(17,400)
Inquiries	235,000	262,400	(27,400)
Provider Education and Training	10,400	10,400	-
Participating Physician	90,000	100,000	(10,000)
Productivity Investment	586,700	586,700	-
PM Special Projects	3,000	3,000	-
Credits	(349,800)	(474,600)	124,800
Subtotal - program management	<u>2,347,500</u>	<u>2,347,500</u>	<u>-</u>
Medical Review	297,200	297,200	-
Medicare Secondary Payer	179,500	179,500	-
Benefits Integrity	116,300	116,300	-
Provider Education and Training	15,000	15,000	-
Subtotal - medicare integrity	<u>608,000</u>	<u>608,000</u>	<u>-</u>
Totals	<u>\$ 2,955,500</u>	<u>2,955,500</u>	<u>-</u>

BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Final Administrative Cost Proposal - Part A

For the Period October 1, 1998 through September 30, 1999

<u>Operation</u>	<u>Budget Authorization</u>	<u>Administrative Costs Claimed</u>	<u>Variance- Favorable (Unfavorable)</u>
Bills/Claims Payment	\$ 555,569	569,569	(14,000)
Appeals/Reviews	24,000	24,000	-
Inquiries	87,900	87,900	-
Provider Education and Training	15,000	15,000	-
Reimbursement	187,400	187,400	-
Productivity Investment	375,500	304,900	70,600
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Subtotal - program management	1,245,369	1,188,769	56,600
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Medical Review	154,500	154,500	-
Medicare Secondary Payer	145,000	145,000	-
Benefits Integrity	18,800	18,800	-
Provider Education and Training	5,900	5,900	-
Audit	711,900	711,900	-
MIP Special Projects	23,100	23,100	-
	<hr/>	<hr/>	<hr/>
Subtotal - medicare integrity	1,059,200	1,059,200	-
	<hr/>	<hr/>	<hr/>
Totals	\$ 2,304,569	2,247,969	56,600
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BLUE CROSS AND BLUE SHIELD  
OF MONTANA

Final Administrative Cost Proposal - Part B

For the Period October 1, 1998 through September 30, 1999

<u>Operation</u>	<u>Budget Authorization</u>	<u>Administrative Costs Claimed</u>	<u>Variance- Favorable (Unfavorable)</u>
Bills/Claims Payment	\$ 1,937,900	1,945,500	(7,600)
Appeals/Reviews	112,200	112,200	-
Inquiries	275,200	275,200	-
Provider Education and Training	45,000	45,000	-
Participating Physician	96,500	96,500	-
Productivity Investments	1,026,900	997,000	29,900
PM Special Projects	1,000	1,000	-
Credits	(530,000)	(537,600)	7,600
Subtotal - program management	<u>2,964,700</u>	<u>2,934,800</u>	<u>29,900</u>
Medical Review	481,900	481,900	-
Medicare Secondary Payer	175,000	175,000	-
Benefits Integrity	41,000	41,000	-
Provider Education and Training	17,000	17,000	-
Productivity Investments	1,500	1,500	-
Subtotal - medicare integrity	<u>716,400</u>	<u>716,400</u>	<u>-</u>
Totals	<u>\$ 3,681,100</u>	<u>3,651,200</u>	<u>29,900</u>

APPENDIX A  
AUDITEE'S RESPONSE



September 10, 2001

Mr. Ronald E. Rolwes, C.P.A.  
Conrad and Associates  
1100 Main Street, Suite C  
Irvine, California 92614

Dear Mr. Rolwes:

Following are our responses to the audit of the Final Administrative Cost Proposals (FACPs) as submitted by Blue Cross Blue Shield of Montana for the administration of the Medicare program (Part A and Part B) during the period October 1, 1997 through September 30, 1999. Our responses correspond to the numbers in the Findings and Recommendations sections.

1. Unallowable Deferred Compensation Costs

We agree that our deferred compensation plan should not be allocated to Medicare per the Federal Acquisition Regulations. We have on our ledger two line items that account for this plan. In the preparation of the FACP for FY1998, one of the line items was included in the non-Medicare adjustment but one of them was missed resulting in an over allocation to Medicare. We concur with this finding and will not charge these expenses to Medicare on future FACP's.

2. Excessive Executive Compensation

We agree that this adjustment was missed when the FACPs for both fiscal years 1998 and 1999 were prepared. We concur with this finding and will include this adjustment on future preparations of the FACPs.

3. Return on Investment Errors

We agree that there were errors made in the calculation of Return on Investment (ROI). Procedures documenting the sources and methods needed to prepare the ROI have been put in place to avoid these errors in the future. It is also recognized that management review is needed and will be done on a routine basis in the future. We concur with the findings as stated.

4. Lack of Consulting Agreements

We have recognized the need to have a better corporate control over consulting agreements made by Blue Cross Blue Shield of Montana. As such, a task group has been formed to improve the contracting and inventory process of consulting agreements made throughout the corporation including the Medicare Program. As such, this finding should be avoided in the future.

Even though we were unable to locate the agreements in question, we still feel that the charges made to the Medicare program represent valid Medicare costs and should be included in allowable costs. However, since the FAR Section 31.205-33(c) states that "services performed under any of the following circumstances are unallowable... (8) Adequacy of the contractual agreements for the service..." we concur with the adjustment as stated.

5. Errors in Reporting Costs Incurred

We agree that someone other than the preparer of the FACPs review the worksheets and schedules used in the preparation of the FACPs. We have already put procedures in place to have management review the FACPs prior to final submission to CMS.

6. Interim Expenditure Reports Procedures Not Adequate

We agree that our current method of preparing the Interim Expenditure Reports (IER) based on estimates is not adequate. This process of estimating arose due to the timing differences with the closing of General Ledger and the due date of the IER. We recognize that a better method needs to be developed to report actual costs and options are presently being reviewed to accomplish this purpose.

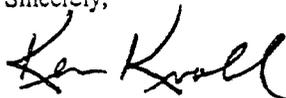
7. Insufficient Documentation of Indirect Cost Allocation

We concur that procedures need to be established to ensure that statistics used in the allocation of indirect overhead costs be timely, adequately documented, and retained for review. We have already put into place several changes to our processes including the centralization of supporting documents, changing our allocation system to allow for a narrative field to detail persons interviewed and allocation changes made, and to develop a schedule for future updates to the allocations. Most all cost allocations are presently being reviewed and will be updated by September 30, 2001.

In addition, we would like to reiterate our position on allowable costs incurred in excess of submitted costs. This information is reflected on Schedules A-D of your audit report. Although we agree with the dollar adjustments noted above, we feel that we have incurred sufficient audited allowable costs to replace those costs that were disallowed. As such, we feel that CMS should replace the disallowed costs with these additional allowable costs and no monies would be owed to CMS. We recognize that Conrad and Associates are not in a position to make this decision, but felt it important to state our position in our response to the findings.

We would like to take this opportunity to thank your staff, especially John Hefner, for the professionalism and patience they exhibited during the course of the audit fieldwork and resolution of the outstanding issues. If you have any questions, feel free to contact me at (406) 444-8287 or you can e-mail me at kknoll@bcbsmt.com.

Sincerely,



Ken Knoll  
Cost Accounting Coach  
Blue Cross Blue Shield of Montana

Cc: Ondrea Knickerbocker, BCBSMT  
Wayne Knutson, BCBSMT  
Mike Wagner, BCBSMT