



Region IX
Office of Audit Services
90 – 7th Street, Suite 3-650
San Francisco, CA 94103

Report Number: A-09-07-00072

Ms. Karen Abraham
Vice President Finance
Blue Cross Blue Shield of Arizona
8220 N. 23rd Avenue
Phoenix, Arizona 85021-4872

FEB 14 2008

Dear Ms. Abraham:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled “Audit of Medicare Administrative Costs Claimed by Blue Cross Blue Shield of Arizona for the Period October 1, 2004, Through September 30, 2006.” We will forward a copy of this report to the HHS action official noted below.

Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5). Accordingly, within 10 business days after the final report is issued, it will be posted on the Internet at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please direct them to the HHS action official. Please refer to report number A-09-07-00072 in all correspondence.

Sincerely,

Lori A. Ahlstrand
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Director, Division of Financial Management, OCFM
Bureau of Program Operations
Centers for Medicare & Medicaid Services
U.S. Department of Health and Human Services
S2-01-23
7500 Security Boulevard
Baltimore, Maryland 21244-1850

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF MEDICARE
ADMINISTRATIVE COSTS
CLAIMED BY BLUE CROSS
BLUE SHIELD OF ARIZONA
FOR THE PERIOD
OCTOBER 1, 2004, THROUGH
SEPTEMBER 30, 2006**



Daniel R. Levinson
Inspector General

February 2008
A-09-07-00072

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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The Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

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The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. Specifically, these evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness in departmental programs. To promote impact, the reports also present practical recommendations for improving program operations.

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The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within HHS. OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops compliance program guidances, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

Department of Health and Human Services

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Notices

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled (Medicare) program, which provides for a hospital insurance program (Part A) and a related supplemental medical insurance program (Part B). The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contracts with private organizations that process and pay Medicare claims. The contracts provide for reimbursement of allowable administrative costs incurred in processing Medicare claims.

CMS contracted with Blue Cross Blue Shield of Arizona (Arizona) to serve as a Medicare intermediary and process Part A claims for the State of Arizona. Appendix B of the contract set forth principles of reimbursement for administrative costs. This appendix cited the Federal Acquisition Regulation (FAR) as regulatory principles to be followed for application to the Medicare contract and provided additional guidelines for specific cost areas.

Arizona reported administrative costs to CMS totaling \$13,944,069 in its Final Administrative Costs Proposals (cost proposals) for fiscal years 2005 and 2006 (October 1, 2004, through September 30, 2006).

OBJECTIVE

Our objective was to determine whether the administrative costs that Arizona claimed in its cost proposals were allowable, allocable, and reasonable in accordance with part 31 of the FAR and the Medicare contract.

SUMMARY OF RESULTS

Of the \$13,944,069 that Arizona claimed in its cost proposals, \$13,234,541 was allowable, allocable, and reasonable in accordance with part 31 of the FAR and the Medicare contract. The remaining \$709,528 represents pension costs that we did not audit; we plan to review these costs in a separate audit. Consequently, this report contains no recommendations. We discussed the results of our audit with Arizona officials.

INTRODUCTION

BACKGROUND

Medicare Intermediary Contracts

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled (Medicare) program, which provides for a hospital insurance program (Part A) and a related supplemental medical insurance program (Part B). The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contracts with private organizations that process and pay Medicare claims.

The contracts with CMS provide for reimbursement of allowable administrative costs incurred in processing Medicare claims. After the close of each fiscal year (FY), contractors submit a Final Administrative Cost Proposal (cost proposal) reporting Medicare costs. Once CMS accepts a cost proposal, the contractor and CMS negotiate a final settlement of allowable administrative costs.

Blue Cross Blue Shield of Arizona Contract

During our audit period (October 1, 2004, through September 30, 2006), CMS contracted with Blue Cross Blue Shield of Arizona (Arizona) to serve as a Medicare intermediary to process Part A claims for the State of Arizona. Pursuant to section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, CMS replaced its claims payment contractors with new contract entities called Medicare Administrative Contractors. As a result, effective October 1, 2006, the contract between CMS and Arizona was terminated.

Appendix B of the contract between Arizona and CMS set forth principles of reimbursement for administrative costs. This appendix cited the Federal Acquisition Regulation (FAR), Title 48 of the CFR, Chapter 1, as regulatory principles to be followed for application to the Medicare contract and provided additional guidelines for specific cost areas.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether the administrative costs that Arizona claimed in its cost proposals were allowable, allocable, and reasonable in accordance with part 31 of the FAR and the Medicare contract.

Scope

Our review covered the period October 1, 2004, through September 30, 2006 (FYs 2005 and 2006). For this period, Arizona reported administrative costs to CMS totaling \$13,944,069.

We excluded pension costs of \$709,528 from the scope of our audit and will perform a separate audit to determine the allowability of these costs. We will also review termination costs in a separate audit.

In planning and performing our audit, we considered the internal control structure to determine our auditing procedures. This evaluation was for the purpose of accomplishing our objective and not to provide assurance on the internal control structure.

We performed our audit from June through November 2007 and conducted fieldwork at Arizona's office in Phoenix, Arizona.

Methodology

To accomplish our objective, we:

- reviewed applicable Medicare laws, regulations, guidelines, applicable sections of the FAR, and Arizona's contract with CMS;
- reconciled the cost proposals to accounting records and to the independently audited financial statements for our audit period;
- reviewed the independent auditor's report related to internal controls to identify possible weaknesses that could affect the allowability of administrative costs;
- obtained an understanding of the cost allocation system;
- reviewed invoices, journal entries, and consultant contracts;
- reviewed payroll journals, corporate bonus plans, and personnel records; and
- tested costs for allowability, allocability, and reasonableness.

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

RESULTS OF AUDIT

Of the \$13,944,069 that Arizona claimed in its cost proposals, \$13,234,541 was allowable, allocable, and reasonable in accordance with part 31 of the FAR and the Medicare contract. The remaining \$709,528 represents pension costs that we did not audit; we plan to review these costs in a separate audit. Consequently, this report contains no recommendations. We discussed the results of our audit with Arizona officials.

The table below details the costs that Arizona claimed in its cost proposals for FYs 2005 and 2006:

<u>Element of Cost</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>Total</u>
Costs Proposed and Accepted:			
Salaries and Wages	\$4,199,707	\$3,766,661	\$7,966,368
Fringe Benefits and Other Compensation	1,058,754	956,987	2,015,741
Depreciation and Use Charges	278,494	259,000	537,494
Data Processing Costs	475,969	474,823	950,792
Professional and Consultant Service Costs	301,948	899,597	1,201,545
General and Administrative Expenses	540,917	437,156	978,073
Other Claimed Costs and Credits	<u>(106,232)</u>	<u>(309,240)</u>	<u>(415,472)</u>
Subtotal	\$6,749,557	\$6,484,984	\$13,234,541
Costs Not Audited:			
Pension Costs	<u>351,597</u>	<u>357,931</u>	<u>709,528</u>
Total	<u>\$7,101,154</u>	<u>\$6,842,915</u>	<u>\$13,944,069</u>