

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF MEDICARE PART-A
ADMINISTRATIVE COSTS**

FISCAL YEARS 1996 - 1997

**INDEPENDENCE BLUE CROSS
PHILADELPHIA, PENNSYLVANIA**



July 2001
A-03-99-00009



DEPARTMENT OF HEALTH & HUMAN SERVICES
OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDIT SERVICES
150 S. INDEPENDENCE MALL WEST
SUITE 316
PHILADELPHIA, PENNSYLVANIA 19106-3499

July 26, 2001

Our Reference: Common Identification Number A-03-99-00009

Mr. John G. Foos
Senior Vice President and Chief Financial Officer
Independence Blue Cross
1901 Market Street
Philadelphia, Pennsylvania 19103

Dear Mr. Foos:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), Office of Audit Services (OAS) final audit report entitled **"REVIEW OF MEDICARE PART-A ADMINISTRATIVE COSTS CLAIMED BY INDEPENDENCE BLUE CROSS FOR FISCAL YEARS 1996 AND 1997."** A copy of this report will be forwarded to the action official noted below for her review and any action deemed necessary.

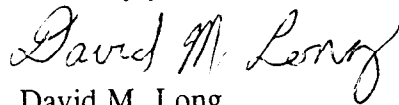
Final determination as to actions to be taken on all matters reported will be made by the HHS action official named below. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe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

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 to members of the press and general public to the extent information contained therein is not subject to the exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5)

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To facilitate identification, please refer to Common Identification Number A-03-99-00009 in all correspondence pertaining to this report.

Sincerely yours,



David M. Long
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Patricia Harris, Acting Regional Administrator
Centers for Medicare and Medicaid Services, Region III
Public Ledger Building Suite 216
150 S. Independence Mall West
Philadelphia, PA 19106-3499

EXECUTIVE SUMMARY

BACKGROUND

This audit report presents the results of an Office of Inspector General (OIG) review of administrative costs claimed by Independence Blue Cross (IBC) for the administration of the Medicare Part A program for Fiscal Years (FYs) 1996 and 1997 (October 1, 1995 - September 30, 1997). During this period, IBC booked and claimed a total of \$24,610,539 in Medicare administrative costs.

The Medicare program is administrated by the Centers for Medicare and Medicaid Services (CMS) formerly known as the Health Care Financing Administration (HCFA) with the assistance from public or private organizations known as Intermediaries or Carriers. The intermediaries are responsible for establishing safeguards against unnecessary payments, as well as the receipt, review, audit and payment of Medicare Part A claims in designated geographical areas. Under an agreement with the Secretary of the Department of Health and Human Services (DHHS), the Blue Cross Association (BCA) participates in the administration of the Medicare Part A program. The IBC, under a subcontract with BCA, was the intermediary responsible for processing Medicare Part A claims and executing the day-to-day operations of the Medicare program in Southeastern Pennsylvania. The IBC opted to terminate the contract as of September 30, 1997.

Program regulations governing the administrative costs reimbursed under the Medicare program are contained in Chapter 1, Part 31 of the Federal Acquisition Regulation (FAR), as interpreted and modified by Medicare contracts, and the Intermediary Manual.

OBJECTIVE

The primary objectives of our review were to determine whether:

- Costs claimed on the Final Administrative Cost Proposals (FACPs) for FYs 1996 and 1997 presented fairly the allowable costs of administration of the Part A program in conformity with reimbursement principles as outlined in Appendix B of the Medicare contract “Principles of the Reimbursement for Administrative Costs” and the provisions of Part 31 of the FAR.
- Costs claimed were reasonable, supported, and benefitted the Medicare program.
- Severance and transition costs represented allowable, allocable, and reasonable costs under the provisions of applicable Federal regulations, the Medicare contract and subcontract agreement, and other CMS instructions.

SUMMARY OF FINDINGS

Our review disclosed that IBC claimed \$4,644,602 in questioned costs. The questioned costs include:

- \$4,146,905 in Excess Costs Claimed over Approved Budgets: The IBC claimed \$4,087,324 and \$59,581 in excess costs over the authorized budgets for FYs 1996 and 1997 respectively, excluding \$497,697 in FY 1997 transition costs. The CMS approved Medicare budgets for IBC totaling \$19,965,937 in administrative costs for these 2 years. During this period, IBC claimed \$24,610,539 or \$4,146,905 more than the approved budgets (excluding the transition costs). Our review showed that IBC did not comply with the requirement to notify CMS for FY 1996 excess costs but did notify CMS about the FY 1997 cost overrun through submission of supplemental budget requests (SBRs) and written correspondence. Included in these questioned costs are \$387,415 in unsupported costs and \$1,021 in unallowable costs.
- \$497,697 in Unfunded Transition Costs: In FY 1997, IBC claimed \$497,697 in transition costs on the FACP which were not approved by CMS. The transition costs represent Medicare Part A program costs incurred during August of 1997. The CMS requested a separate budget for transition costs but IBC did not submit a SBR for these costs. We are questioning the transition costs for lack of funding. Furthermore, the transition costs claimed include \$92,716 in unsupported costs.

RECOMMENDATIONS

We are not making recommendations in this report for procedural improvements since IBC voluntarily opted to discontinue the Medicare Part A program as of September 30, 1997. However, we are recommending that IBC:

- Coordinate with CMS to reduce the costs claimed for FYs 1996 and 1997 by \$4,644,602 including \$4,146,905 in excess costs and \$497,697 in unfunded transition costs.

On March 16, 2001, IBC responded to a draft of this report. In its response IBC generally disagreed with our findings related to costs claimed over approved budgets, unapproved costs and inadequately documented costs. The IBC agreed to provide additional information to enable OIG to review salary and wage costs which the OIG considered unsupported in the draft report.

The OIG performed additional follow-up review of salary and wage costs claimed by IBC using the new information provided by IBC. We were able to determine that the salaries and wages claimed by IBC were supported and properly allocated except for costs previously questioned in the draft report. We have not changed our position related to other findings.

The IBC response has been summarized and incorporated in this report. We have also attached the response as an appendix to the report. The IBC exhibits to the response were too voluminous to be included with the report, but they will be provided to CMS.

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INTRODUCTION

BACKGROUND

The Health Insurance for the Aged and Disabled Program (Medicare), Title XVIII of the Social Security Act, provides for a hospital insurance program (Part A) and a related medical insurance program (Part B). Medicare covers: (1) eligible persons aged 65 and over; (2) disabled persons under 65 who have been entitled to Social Security or railroad retirement benefits for at least 24 consecutive months; and (3) individuals under age 65 who have chronic kidney disease and are insured by or entitled to Social Security benefits.

The Medicare program is administered by the Centers for Medicare and Medicaid Services (CMS) formerly known as the Health Care Financing Administration (HCFA) with the assistance from public or private organizations known as Intermediaries or Carriers. The intermediaries are responsible for establishing safeguards against unnecessary payments, as well as the receipt, review, audit and payment of Medicare Part A claims in designated geographical areas. Under an agreement with the Secretary of the Department of Health and Human Services (DHHS), the Blue Cross Association (BCA) participates in the administration of the Medicare Part A program. The Independence Blue Cross (IBC), under a subcontract with BCA, was the intermediary responsible for processing Medicare Part A claims and executing the day-to-day operations of the Medicare program in Southeastern Pennsylvania. The IBC opted to terminate the contract as of September 30, 1997.

Program regulations governing the administrative costs reimbursed under the Medicare program are contained in Chapter 1, Part 31 of the Federal Acquisition Regulation (FAR), as interpreted and modified by Medicare contracts, and the Intermediary Manual.

OBJECTIVE, SCOPE AND METHODOLOGY

Our audit was conducted in accordance with generally accepted government auditing standards. The primary purposes of the review were to determine whether:

- Costs claimed on the Final Administrative Cost Proposals (FACPs) for Fiscal Years (FYs) 1996 and 1997 presented fairly the allowable costs of administration of the Part A program in conformity with reimbursement principles as outlined in Appendix B of the Medicare contract “Principles of the Reimbursement for Administrative Costs” and the provisions of Part 31 of the FAR.
- Costs claimed were reasonable, supported, and benefitted the Medicare program.
- Severance and transition costs represented allowable, allocable, and reasonable costs under the provisions of applicable Federal regulations, the Medicare contract and subcontract agreement, and other CMS instructions.

We performed audit procedures necessary to achieve the objectives of the audit. We used judgmental sampling techniques to select a sample of administrative costs for review. We selected and reviewed certain cost centers and accounts to determine if amounts claimed were adequately supported, reasonable and allowable in accordance with applicable Federal regulations and guidelines.

During FYs 1996 and 1997, IBC claimed \$24,610,539 in administrative costs on the FACP's. We judgementally selected \$1,728,210 in administrative costs allocated to Medicare. Our samples were designed to achieve our objectives and included payroll and non-payroll costs, complementary credits, transition costs, and cost allocation methods. We also performed a review of \$345,104 in severance costs that IBC had not claimed at the time of our initial review but which were subsequently claimed by voucher.

RESULTS OF AUDIT

During FYs 1996 and 1997, IBC claimed administrative costs totaling \$24,610,539. Our review disclosed \$4,644,602 in questioned costs which includes claimed costs that exceeded the approved budgets by \$4,146,905 and \$497,697 in unfunded transition costs. In addition, the questioned administrative costs claimed by IBC included \$480,131 of costs (\$387,415 in FACP administrative costs and \$92,716 in transition costs) for which the documentation supporting the expense was either not provided or proved inadequate to determine the nature, type, reasonableness, or necessity of the expense and \$1,021 of unallowable costs.

We found that \$345,104 in severance costs claimed by IBC on a voucher subsequent to our initial review were reasonable, in accordance with IBC's stipulated severance policy and accurately allocated among IBC's various lines of business.

Excess Costs Claimed over Approved Budgets - \$4,146,905

The IBC claimed \$4,146,905 in excess of the authorized budgets excluding transition costs. The CMS approved Medicare budgets for IBC totaling \$19,965,937 in administrative costs for FYs 1996 and 1997. During this period, IBC claimed on its FACP's \$24,610,539 or \$4,146,905 more than approved by CMS excluding transition costs of \$497,697. The cost overruns consisted of \$4,087,324 in 1996 and \$59,581 in 1997. Our review showed that IBC did not comply with the notification requirement for the FY 1996 cost overrun but did notify CMS about the FY 1997 cost overrun through submission of Supplemental Budget Requests (SBRs) and written correspondence. We are questioning \$4,146,905 in excess costs of which \$4,087,324 occurred in FY 1996 and \$59,581 was claimed for 1997 excluding transition costs. These costs also include \$387,415 in unsupported costs and \$1,021 in unallowable costs.

The IBC did not notify CMS of the FY 1996 cost overrun. The Medicare agreement, Article VI Cost of Administration, paragraph H, stipulates that if at any time it appears that the approved budget will not be sufficient to cover administrative costs for the fiscal year, the intermediary shall notify the Secretary. In no event should the notification be less than 60 calendar days prior to the date in which it is estimated that the budget amount will be exhausted, unless the intermediary can demonstrate that such notice could not have been given within that time frame. The notification should also contain the intermediary's proposal as to how costs expected to be incurred may be reduced.

The excess costs occurred because IBC did not adhere to the budget limitations and restrictions. The FY 1996 cost overrun stemmed primarily from electronic data processing and overhead costs not included in the approved budget. The IBC officials stated that in prior years, IBC only claimed costs up to the authorized ceiling amount to adhere to budget restrictions. However, IBC decided not to absorb these costs and claimed the entire cost incurred starting in FY 1996. The IBC did not notify CMS within 60 days that the authorized funding was not sufficient to cover administrative costs so that matter could be mutually resolved. Furthermore, the IBC did not request additional funding through submission of SBRs.

The FY 1997 cost overrun of \$557,278 consists of \$497,697 in transition costs and \$59,581 in continuing operation costs. We included the \$59,581 as part of excess costs over the budgets and reported the transition costs in a separate area. As required, IBC notified CMS about the FY 1997 cost overrun but CMS did not approve the funding.

IBC Comment

In its response, IBC did not agree with our conclusion that costs claimed over approved budgets should not be paid because a SBR was not submitted by IBC or, in the case where IBC provided notification to CMS, approval was not received from CMS to incur the costs. The IBC provided a declaration from the Manager of the Administrative Budgets Department who stated that CMS was, in fact, notified that IBC's administrative costs would exceed the budget authority. The declaration further stated that CMS informed IBC that IBC would be permitted to request additional funding for non-reimbursed cost based on audited data. The IBC also provided additional correspondence to CMS concerning the 1997 cost overrun.

OIG Response

The IBC did not provide any additional information that contradicted our position. The IBC notification to CMS concerning FY 1996 costs was not made until FY 1997 and did not include the SBR. Our additional review of CMS documents did not disclose any approval by CMS. The CMS, in fact, expressed the concern that they were not notified timely concerning the FY 1996 overrun.

We will provide the complete IBC response to CMS to assist in the resolution of this issue.

Unsupported Costs - \$387,415

The IBC claimed \$387,415 in costs (FY 1996 - \$156,129 --- FY 1997 - \$231,286) for which the documentation supporting expenses was either not provided or not adequate to determine the nature, type, reasonableness, or necessity of the expenses. We made numerous requests to IBC to provide supporting documentation; however, IBC did not provide such documentation. Section 1504 of the CMS Intermediary Manual states that:

“The intermediary shall maintain books, records, documents and other evidence pertaining to the costs and expenses of the agreement...These records shall be maintained to the extent and in such detail as will properly reflect all net costs, direct and indirect, of labor, materials, equipment, and supplies and services, and other costs and expenses of whatever nature claimed to have been incurred, and for which reimbursement is claimed under the provisions of the agreement.”

Schedule of Unsupported Costs

Cost Element	Total Amount Reviewed	Non-Medicare Amount	Medicare Amount	Medicare Amount Questioned
Incentive Bonus	\$1,348,536	\$1,242,946	\$105,590	\$105,590
Tuition Costs	2,205	0	2,205	2,205
Health Insurance	124,121	65,651	58,470	58,470
401K Contribution	51,250	47,237	4,013	4,013
Training and Education	23,955	19,222	4,733	3,353
Recruiting and Employment	45,126	40,598	4,528	223
Building Services	208,801	170,125	38,676	38,676
Amortization of Software	421,127	376,752	44,375	41,085
Equipment Rental	106,801	93,323	13,478	2,382
Equipment Maintenance	33,794	29,554	4,240	1,689
Depreciation of Building	23,820	21,360	2,461	1,451
Travel and Conference	404	0	404	214
Printing and Stationary	13,361	0	13,361	13,361
Office Supplies	29,537	26,448	3,089	999
Computer Supplies	12,047	10,929	1,118	629

Postage	455,310	422,344	32,966	15,107
Telephone	47,766	31,104	16,662	12,108
Committee Expenses	2,109	0	2,109	2,109
Consulting Services	177,105	154,217	22,888	4,566
Purchased Services - Other	74,634	65,072	9,562	6,175
Purchased Services - Personnel	21,063	18,284	2,779	1,320
Cost of Capital	102,625	91,513	11,112	11,112
Return on Investment	191,321	141,943	49,378	22,614
IS Programmer Chargeback	177,730	156,958	20,772	20,772
IS Mainframe Chargeback	89,882	45,637	44,245	17,192
Total	\$3,784,430	\$3,271,217	\$513,214	\$387,415

The IBC was either unable to locate or was searching for requested documentation at the completion of our field work. The unsupported costs are summarized as follows:

Incentive Bonus - \$105,590

We reviewed \$105,590 in incentive bonus payments allocated to Medicare. Incentive bonus payments were based on meeting certain IBC goals as well as base salary. Incentive bonus payments were initially accumulated in one cost center and then allocated based on eligible participants categorized by tiers, a percentage of base pay and corporate goals. The IBC provided no documentation to support this cost except for general information about the bonus payment and basis of bonus distribution. Since IBC did not provide documentation necessary to support the bonus costs calculation, such as payroll data, we are questioning \$105,590 in bonus payments for lack of adequate support.

Tuition Costs - \$2,205

We reviewed \$2,205 in tuition costs and requested documentation supporting the costs to determine the nature, reasonableness, or necessity of the expense. The IBC provided no documentation to support the tuition costs claimed. As a result, we are questioning \$2,205 for lack of supporting documentation.

Health Insurance - \$58,470

We reviewed \$58,470 in health insurance costs allocated to Medicare and requested supporting documentation, such as actuarial report and statistics, to test the accuracy and reasonableness of the claimed costs. The IBC provided a copy of a journal entry printout and a head count allocation statistics report. Based on the limited documentation provided to support the costs,

we were unable to determine the accuracy, validity and reasonableness of the health insurance costs claimed. We are questioning \$58,470 in health insurance costs allocated to Medicare.

401K Contribution - \$4,013

We reviewed \$4,013 in 401K Contributions allocated to Medicare which represents the matching contributed by IBC on behalf of participating employees. The matching contribution amount is accumulated in the incentive bonus cost center and then allocated to various lines of businesses. We requested documentation supporting the costs to determine the nature, reasonableness, or necessity of the expense. The IBC, however, provided no documentation to support the 401K contribution claimed. As a result, we are questioning \$4,013 for lack of supporting documentation.

Training and Education - \$3,353

We reviewed \$4,733 in training and education costs allocated to Medicare. The amount claimed represents training costs such as seminars, workshops and other courses intended to improve employees' job skills. The IBC did not provide supporting documentation such as vendor invoices for \$3,353 in training and education costs claimed. As a result, we are questioning \$3,353 for lack of supporting documentation.

Recruiting and Employment - \$223

We reviewed \$4,528 in recruiting and employment costs allocated to Medicare. The amount claimed represents the costs associated with recruiting and hiring of employees such as employment fees, employment advertising, relocation expenses and etc. The IBC provided no support documentation, such as vendor invoices, for \$223 in Medicare costs. Therefore, we are questioning \$223 for lack of supporting documentation.

Building Services - \$38,676

We reviewed \$38,676 in building services costs allocated to Medicare. The building service account captures the costs associated with the general operation of the headquarters facility such as maintenance, utilities, and other related expenses. Building costs are initially accumulated in one cost center and then allocated to all lines of business based on monthly square footage statistics. The IBC provided no supporting documentation for FY 1996 building services expense of \$22,592 and provided inadequate support documentation for FY 1997 building services expense of \$16,084. Since IBC did not provide the necessary support documentation, such as vendor invoices, we are questioning \$38,676 in building services costs.

Amortization of Software - \$41,085

We reviewed \$44,375 in software amortization expenses allocated to Medicare. This amount represents the amortization of software purchases exceeding \$2,000. The IBC provided no

supporting documentation for FY 1996 software amortization expenses of \$28,869 and provided inadequate support documentation for FY 1997 amortization expenses of \$12,216. We are questioning \$41,085 of the \$44,375 in software amortization expenses for lack of support.

Equipment Rental - \$2,382

We reviewed \$13,478 in equipment rental costs allocated to Medicare. The IBC did not provide vendor invoices to support \$2,382 in Medicare costs. We are questioning \$2,382 in equipment rental costs for lack of supporting documentation.

Equipment Maintenance - \$1,689

We reviewed \$4,240 in equipment maintenance EDP allocated to Medicare. We did not receive any documentation for \$1,689 allocated to Medicare. As a result, we are questioning \$1,689 for lack of documentation.

Depreciation of Building - \$1,451

We reviewed \$2,461 in building depreciation costs allocated to Medicare. The building is depreciated using the straight-line method over a useful life of 50 years. The monthly depreciation amount is allocated to the building components based on square-footage. We did not receive any documentation to support \$1,451 in building depreciation costs for FY 1996. As a result, we are questioning Medicare costs of \$1,451 for lack of supporting documentation.

Travel and Conference - \$214

We reviewed \$404 in travel and conference costs. The amount reviewed was coded directly to a 100 percent dedicated Medicare cost center and therefore did not benefit other lines of business. We did not receive supporting documentation such as vendor invoices and travel receipts for \$214 in travel and conference costs. As a result, we are questioning \$214 for lack of support.

Printing and Stationary - \$13,361

We reviewed \$13,361 in printing and stationary costs. The amount reviewed was coded directly to a 100 percent dedicated Medicare cost center and therefore did not benefit other lines of business. We did not receive any documentation, such as vendor invoices, to support the \$13,361 allocated to Medicare. As a result, we are questioning \$13,361 for lack of support.

Office Supplies - \$999

We reviewed \$3,089 in office supplies expense allocated to Medicare. The IBC provided no documentation to support \$197 and provided insufficient documentation for \$802 in office supply costs. As a result, we are questioning \$999 for lack of support.

Computer Supplies - \$629

We reviewed \$1,118 in computer supplies costs allocated to Medicare. We did not receive any documentation such as vendor invoices to support \$629 allocated to Medicare. As a result, we are questioning \$629 for lack of documentation.

Postage - \$15,107

We reviewed \$32,966 in postage costs allocated to Medicare. Postage costs are initially accumulated in one cost center and then allocated to benefitting lines of business based on corporate overhead statistics. The IBC did not provide documentation such as postage studies and invoices to support \$14,882 in postage costs allocated to Medicare in FY 1996. For FY 1997, the amount claimed exceeded the amount supported by \$225. As a result, we are questioning \$15,107 for lack of support.

Telephone - \$12,108

We reviewed \$16,662 in telephone costs allocated to Medicare. Telephone costs are initially accumulated in one cost center and then allocated to benefitting lines of business based on corporate overhead statistics. The IBC did not provide documentation such as vendor invoices to support \$12,108 in telephone costs allocated to Medicare for FY 1997. As a result, we are questioning \$12,108 for lack of support.

Committee Expenses - \$2,109

We reviewed \$2,109 in committee costs. The amount reviewed was coded directly to a 100 percent dedicated Medicare cost center and therefore was not allocated to other lines of businesses. We did not receive supporting documentation, such as invoices and expense reports, to test the costs; therefore, we are questioning \$2,109 for lack of support.

Consulting Services - \$4,566

We reviewed \$22,888 in consulting costs allocated to Medicare. We did not receive any supporting documentation, such as vendor invoices, for \$4,566 of the \$22,888 in consulting costs. As a result, we are questioning \$4,566 for lack of support.

Purchased Services - Other - \$6,175

We reviewed \$9,562 in purchased services costs allocated to Medicare. The IBC did not provide documentation such as vendor invoices to support \$6,175 of costs allocated to Medicare. As a result, we are questioning \$6,175 for lack of support.

Purchased Services - Personnel - \$1,320

We reviewed \$2,779 in purchased personnel services costs allocated to Medicare. The IBC did not provide documentation such as vendor invoices to support \$1,320 in Medicare costs; therefore, we are questioning \$1,320 for lack of support.

Cost of Capital - \$11,112

We reviewed \$11,112 in cost of capital costs allocated to Medicare. Cost of capital is calculated by multiplying the current return on investment rate by the current net booked value of the fixed assets excluding the 1901 Market Street building. The IBC did not provide documentation supporting the net book value computation and the fixed asset listing. As a result, we are questioning \$11,112 in cost of capital allocated to Medicare for lack of adequate support.

Return on Investment - \$22,614

We reviewed \$49,378 in Return on Investment (ROI) allocated to Medicare. The ROI is calculated based on the net book value of the headquarters facility times the treasury rate. The IBC did not provide documentation supporting the return on investment net book value computation for FY 1996. As a result, we are questioning \$22,614 in cost of capital allocated to Medicare for lack of support.

Information System (IS) Programmer Chargeback - \$20,772

We reviewed \$20,772 in IS programmer chargeback costs allocated to Medicare. The programmer chargeback account is used to track programmers' time by project. The cost is first accumulated into one cost center and then charged back to user cost centers based on programmers' time spent. The IBC provided a schedule showing how the costs were allocated to various user centers without any back up supporting documents. We requested programmers' time sheets, a listing of projects and time spent on each project to test the validity and reasonableness of the chargebacks. We did not receive sufficient documentation to adequately support the nature and validity of the costs. As a result, we are questioning \$20,772 in programmer chargebacks for lack of adequate support.

IS Mainframe Chargeback – \$17,192

We reviewed \$44,245 in information system chargeback costs allocated to Medicare. The information system chargeback account captures the costs associated with operating the mainframe computer system. The cost is first accumulated into the data center and then charged back to user cost centers. We did not receive documentation to support \$17,192 in information system chargeback allocated to Medicare for FY 1996. As a result, we are questioning \$17,192 for lack of support.

Unallowable Costs - \$1,021

In FY 1996, IBC allocated \$1,021 in Purchased Services costs that did not benefit Medicare. The IBC allocated Medicare \$1,021 of an \$11,000 invoice submitted by Standard and Poor's for rating services. The FAR 31.201-4 states that a cost is allocable to a Government contract if it benefits the contract and can be distributed to the contract in a reasonable proportion based on benefits received. The IBC representatives agreed that Medicare did not receive any benefit from these services.

IBC Comment

The IBC disagreed with several of our findings but cited only five areas specifically. The IBC believed that it provided all documentation requested by OIG to the extent that the information was available. In certain cases supporting documentation could not be found or the information was illegible. The IBC believed that OIG, in those cases, should have extended testing or should have selected from an additional/alternative sample. The IBC stated that it had additional information and would make it available, if requested.

OIG Response

Contrary to IBC's assertion, the OIG routinely and repeatedly requested information in support of the claimed costs under OIG review. The information for the areas of questioned costs was either not provided or was insufficient to support the claim. The IBC recognized that in certain cases the information was not available or was unsuitable because of illegibility. In those cases, IBC believes that OIG should have substituted for the sampled item or extended testing. The OIG did extend testing in many areas but the information was not forthcoming. If the information is subsequently requested by CMS for the resolution of the audit and provided by IBC, we will be available to perform additional review. However, the initial review was delayed by the lack of information or IBC's reluctance to release salary and wage information to OIG. Had the information been provided timely and completely, perhaps some of the outstanding issues would have been resolved earlier.

Unfunded Transition Costs - \$497,697

The IBC claimed \$497,697 in transition costs during FY 1997. The IBC treated activities during the entire month of August 1997 as transition costs. The IBC claimed \$557,278 more than the authorized budget for FY 1997 of which \$497,697 was for transition costs which were never authorized by CMS.

The IBC did not submit a transition cost budget with an explanation of the cost categories despite CMS' request for one. Since IBC did not submit a transition budget, CMS did not authorize funding for transition costs. Therefore, we are questioning the entire transition cost for lack of funding authorization. Further, IBC was unable to provide sufficient documentation to enable the OIG to determine the nature, type, reasonableness or necessity of \$92,716 in transition costs.

IBC Comment

The IBC did not agree with the OIG position that unfunded transition costs that exceeded the budget were unallowable because the costs were never authorized by CMS. The IBC cites a letter from the Director of CMS' Bureau of Program Operations which states that the payment of Transition Costs will be paid in accordance with Paragraph I of the Cost of Administration article after the costs have been audited. The negotiation of allowable costs will be determined in accordance with part 31 of the FAR and the Medicare agreement.

OIG Response

We continue to question the entire amount claimed for Transition costs because IBC was not responsive to CMS' request for budget information. The CMS letter cited by IBC did increase the overall budget but did not specifically cite any approval for transition costs. The CMS maintained that all costs were subject to audit. This should not imply that IBC could (or should) incur transition costs and that they would be approved if otherwise allowable. The transition costs were subject to prior budgetary approval which CMS never provided because a budget was not prepared by IBC.

Unsupported Costs - \$92,716

In addition to the lack of approval, we are questioning \$92,716 of the \$497,697 for lack of adequate support.

We reviewed \$412,400 in transition costs allocated to Medicare. The IBC was either unable to locate documentation or was still searching for the requested documentation to support \$92,716 at the completion of our field work. The unsupported transition costs consisted of:

- ▶ **Health Insurance - \$2,768:** We reviewed \$2,768 in health insurance costs allocated to Medicare and requested supporting documentation, such as actuarial reports and statistics, to test the accuracy and reasonableness of the claimed costs. The IBC provided a copy of a journal entry printout and a head count allocation statistics report. This limited information was not sufficient to enable OIG to determine the accuracy, validity and reasonableness of the health insurance costs claimed. As a result, we are questioning \$2,768 in health insurance costs allocated to Medicare for lack of adequate documentation.

- ▶ **Building Services - \$155:** We reviewed \$54,857 in non-billable electricity costs of which \$1,942 or 3.54 percent was allocated to Medicare. The non-billable electricity costs are based on a \$250,101 electric bill. The IBC provided documentation supporting only \$229,348 of the \$250,101 electric bill resulting in a total unsupported amount of \$20,753. The Medicare portion of the unsupported costs is \$155.

- ▶ **Amortization of Leasehold Improvements - \$28,320:** The amortization amount is based on the original lease amount of \$158,361. We did not receive documentation supporting the initial lease agreement and terms of the original lease to determine the nature and validity of the costs. Therefore, we are questioning \$28,320 in Medicare costs for lack of support.
- ▶ **Amortization of Software - \$4,730:** We reviewed \$5,782 in software amortization expenses allocated to Medicare. The IBC provided supporting documentation for \$1,053. The IBC did not provide documentation such as initial acquisition costs of the software as well as the amortization basis to support \$4,730. As a result, we are questioning \$4,730 for lack of support.
- ▶ **EDP Equipment Maintenance - \$147:** We reviewed \$4,544 in equipment maintenance costs. The IBC did not provide support such as vendor invoices to support \$147 allocated to Medicare. As a result, we are questioning \$147 for lack of documentation.
- ▶ **Telephone Expense - \$2,095:** We reviewed \$2,095 in telephone costs allocated to Medicare. The IBC provided several invoices to support the amount reviewed. However, we were unable to reconcile the invoices to the amount under review. As a result, we are questioning \$2,095 for inadequate documentation.
- ▶ **Consulting Services - \$1,354 :** We reviewed \$2,774 in consulting costs allocated to Medicare. We received illegible documentation in support of \$1,354. As a result, we are questioning \$1,354 for lack of adequate documentation.
- ▶ **Purchased Services - Other \$474 :** We reviewed \$499 in purchased service costs allocated to Medicare. The IBC was unable to provide any support for \$474. As a result, we are questioning \$474.
- ▶ **Purchased Services - Personnel \$6,706:** We reviewed \$20,227 in purchased personnel service allocated to Medicare which represents the costs associated with temporary employees who worked for the Medicare line of business. The IBC did not provide documentation, such as vendor invoices, to support \$6,706 in Purchase Service Personnel costs. We are questioning \$6,706 for lack of support.
- ▶ **Software License Expense - \$10,767:** We reviewed \$11,566 in software license amortization allocated to Medicare. Software licenses were amortized over 3 years or over the stated license period. The IBC did not provide adequate documentation, such as vendor invoices, to support \$10,767 in Software Expense. As a result, we are questioning \$10,767.

- ▶ **Contract Programmer Expense - \$2,591:** We reviewed \$4,928 in contract programmer costs allocated to Medicare. We received illegible vendor invoices to support \$2,591 in Contract Programmer Expense. As a result, we are questioning \$2,591 for lack of adequate documentation.
- ▶ **Cost of Capital - Equipment - \$836:** We reviewed \$836 in cost of capital allocated to Medicare. Cost of capital is calculated by multiplying the current return on an investment rate by the current net asset value. The IBC did not provide documentation supporting the net asset value calculation and a listing of the fixed assets to test the cost of capital calculation. As a result we are questioning \$836 for lack of support.
- ▶ **Information System Programmer Chargeback - \$25,721:** We reviewed \$25,721 in programmer chargeback costs allocated to Medicare. The IBC did not provide documentation such as project request, time spent on each project, and the costs associated with each project. As a result, we are questioning 25,721 for lack of adequate support.
- ▶ **Capitalized Programming - \$6,052:** We reviewed \$6,052 in capitalized programming costs allocated to Medicare. This amount represents the costs associated with the contract programmers. Costs are first accumulated into one cost center and then allocated to user departments. The IBC did not provide any documentation such as vendor invoices to support \$6,052 in capitalized programming costs. As a result, we are questioning \$6,052 for lack of support.

IBC Comment

The IBC disagreed with several of our findings but cited only five areas specifically. The IBC believed that it provided all documentation requested by OIG to the extent that the information was available. In certain cases supporting documentation could not be found or the information was illegible. The IBC believed that OIG, in those cases, should have extended testing or should have selected from an additional/alternative sample. The IBC stated that it had additional information and would make it available, if requested.

OIG Response

Contrary to IBC's assertion, the OIG routinely and repeatedly requested information in support of the claimed costs under OIG review. The information for the areas of questioned costs was either not provided or was insufficient to support the claim. The IBC recognized that in certain cases the information was not available or was unsuitable because of illegibility. In those cases, IBC believes that OIG should have substituted for the sampled item or extended testing. The OIG did extend testing in many areas, but the information was not forthcoming. If the information is subsequently requested by CMS for the resolution of the audit and provided by IBC, we will be available to perform additional review. However, the initial review was delayed

by the lack of information or IBC's reluctance to release salary and wage information to OIG. Had the information been provided timely and completely, perhaps some of the outstanding issues would have been resolved earlier.

Severance Payments- \$345,104

The IBC provided a schedule showing \$345,104 in severance payments including salaries and fringe benefits for 14 employees who worked for Medicare at the time of contract termination. The IBC claimed these costs by voucher after the completion of our initial field work. At CMS' request we returned to IBC to review the severance claim to determine whether severance costs were reasonable and allocable in accordance with FAR, CMS and IBC guidelines. Our review found that severance costs were reasonable, in accordance with Federal guidelines and IBC's policies and properly allocated to benefitting lines of business.

CONCLUSIONS AND RECOMMENDATIONS

Our review of Medicare costs claimed by IBC for FYs 1996 and 1997 showed that IBC claimed \$4,644,602 in costs that was in excess of approved budgets and costs that were not funded by CMS. Included in these costs are \$480,131 in unsupported costs and \$1,021 in unallowable costs.

We are not making recommendations in this report for procedural improvements since IBC voluntarily opted to discontinue the Medicare Part A program as of September 30, 1997. However, we are recommending that IBC:

- Coordinate with CMS to reduce the costs claimed for FYs 1996 and 1997 by \$4,644,602 including \$4,146,905 in excess costs and \$497,697 in unfunded transition costs.



Independence
Blue Cross

1901 MARKET STREET
PHILADELPHIA, PA 19103-1480

March 16, 2001

VIA HAND DELIVERY

Mr. David M. Long
Regional Inspector General for Audit Services
Department of Health & Human Services
150 S. Independence Mall West
Suite 316
Philadelphia, PA 19106-3499

Re: Draft Audit Report Ref # A-03-99-00009

Dear Mr. Long:

Independence Blue Cross ("IBC") has received HCFA's draft audit report dated January 18, 2001. Pursuant to a discussion with the audit staff, we received a 30-day extension of time for submission of our response. This letter and attachments constitutes our response to draft audit report Reference # A-03-99-00009 regarding Contract No. HCFA 87-001-1.72 ("Contract") for fiscal years 1996 and 1997. This response contains IBC proprietary and confidential information that is exempt from release under the Freedom of Information Act. Prior to any release by your office, we request that notice be given to IBC and an opportunity to take appropriate steps to protect its confidential information.

The draft audit report essentially relies on two arguments to disallow significant IBC costs: (1) IBC failed to submit a supplemental budget request or failed to notify HCFA of cost overruns; and (2) IBC did not provide adequate documentation to the auditors to support its costs. These assertions are simply not accurate. First, as discussed below, and as your office should be fully aware, IBC had discussions with HCFA about its administrative cost situation for both 1996 and 1997. HCFA told IBC that it could request additional funding and IBC relied on HCFA's representations. Second, IBC provided available documentation to the auditors as requested. Where documentation was not available, IBC suggested that the auditors examine similar transactions or view a different sample — those suggestions were not heeded. Obviously, if the auditors need to review further documentation, IBC will make it available promptly.

Further, no exit conference was held at the completion of the fieldwork. We would like the opportunity of an exit conference and have discussed it with your staff.



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Cost Claimed Over Approved Budgets (Excluding Transition Costs) -
\$4,146,905

The draft audit report states that IBC did not submit a supplemental budget request ("SBR") for fiscal year 1996 and while an SBR was submitted for fiscal year 1997, it was not approved by HCFA. Draft Audit Report at 2. The amounts at issue are \$4,087,324 for fiscal year 1996 and \$59,581 for fiscal year 1997. The draft audit report recommends disallowance based on such alleged lack of notice and/or approval.

HCFA may not rely on the asserted failure to submit an SBR to deny payment of fiscal year 1996 costs. During discussions between HCFA and IBC that took place in the Fall of 1996 when IBC was finalizing its 1996 Final Administrative Cost Proposal ("FACP"), IBC advised HCFA that it would overrun the amount set forth in the approved Notice of Budget Approval ("NOBA") for 1996. These discussions were between Robert Larson and Larry Chosed of the Regional Office and Ed Kelly of IBC. Kelly Declaration ¶¶ 2-3. (Attachment 1). At that time, IBC advised HCFA that IBC was considering whether to exit the Medicare Program. Kelly Declaration ¶ 2. The HCFA regional office personnel stated that IBC could submit full cost rather than the amount set forth in the NOBA. Kelly Declaration ¶ 3. HCFA's representatives also stated that when the audit was complete and final cost had been determined, IBC would be able to request additional funding for non-reimbursed cost based on audited data. Kelly Declaration ¶ 3. In reliance on these statements by HCFA, IBC did not submit an SBR for fiscal year 1996. Kelly Declaration ¶ 3.

The Cost of Administration article in the Contract requires HCFA to reimburse IBC for its allowable costs. Contract, Article VI(C). The contract further provides that a Plan, such as IBC, "shall be paid its costs of administration under the principle of neither profit nor loss to the Plan."

The Cost of Administration article provides that the reimbursed costs cannot exceed the annual amount on the NOBA "without prior approval of the Secretary, or as subject to paragraph I." Contract, Article VI(C). Paragraph I provides:

If the amount of costs incurred by the Plan which are determined to be allowable upon final settlement exceeds the budgeted amount, the Secretary shall pay such costs



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provided that the requirements of paragraph H have been met by the Plan, and provided further that funds are available to the Secretary for intermediary and carrier administration.

Paragraph H of Article VI addresses how a Plan may give notice of an anticipated overrun of a NOBA. Notice may be given by telephone and confirmed by letter. *Id.* Paragraph H contemplates — but does not require — that the parties might negotiate a reduction in the scope of work to avoid exceeding the NOBA. Paragraph H also provides that the Secretary may waive any of the specified time periods.

Fiscal Year 1996

Beginning in October 1996, IBC notified HCFA that it expected its incurred costs would exceed the NOBA before it submitted its FACP for 1996. Kelly Declaration ¶¶ 2-3.¹ In response, HCFA advised IBC that it could submit full cost and that such costs would be reimbursed in accordance with the Cost of Administration article. Kelly Declaration ¶ 3. HCFA also stated that when the audit was complete and final cost determined, IBC would be able to request additional funding for non-reimbursed cost based on audited data. *Id.* To the extent there were any deviations from the notice provisions in Article VI(H), therefore, HCFA waived them and accepted the notice as given.

As courts and boards of contract appeals have recognized in cases involving more stringent provisions than the Cost of Administration article at issue here (such as Limitation of Cost clauses), there are a number of instances in which the Government may not invoke a notice requirement to bar reimbursement of allowable costs a contractor has incurred in performing a contract.

First, the Government cannot establish prejudice from lack of notice if it is unlikely the Government would have directed the contractor to stop work even if it had prior notice. *E.g., Dames & Moore*, IBCA No. 2553, 93-1 BCA ¶ 25,487 at 126,976. Here, even if the oral notice provided with regard to 1996 were not adequate for purposes of the Cost of Administration clause (which IBC denies), HCFA's response

¹ Unless otherwise noted, references to years are to fiscal years.



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thereto indicates that HCFA likely would not have directed IBC to stop work. To the contrary, HCFA directed IBC to continue work.

Second, nothing prevents a contracting officer from exercising his discretion to fund an overrun. In *Johnson Controls World Services, Inc. v. United States*, 48 Fed. Cl. 479 (2001), the contracting officer decided that it was appropriate to fund an overrun of the amount covered by the Limitation of Cost clause. After the agency later sought to deny payment of such costs based on the Limitation of Cost clause, the Court of Federal Claims ruled that the agency could not invoke the clause to avoid payment. See also *General Electric Co. v. United States*, 412 F.2d 1215 (Ct. Cl. 1969). Here, HCFA authorized IBC to incur costs after the NOBA amount had been reached. HCFA's statements in 1996 were made with knowledge of an overrun and bound HCFA to compensate IBC. *Johnson Controls*.

Furthermore, HCFA waived any requirement to submit an SBR for 1996 by leading IBC reasonably to believe that an SBR would not be required under the circumstances where IBC had determined to exit the Program and so notified HCFA.

Fiscal Year 1997

Similarly, HCFA may not rely on the failure to submit an SBR for 1997 to deny payment. Consistent with Article VI(H), IBC repeatedly notified HCFA beginning in March 1997 that it expected its incurred costs would exceed the NOBA. IBC further advised HCFA that it would cease work if HCFA did not authorize additional funding. (Attachments 2, 3). HCFA did not direct IBC to cease work under the Contract. HCFA also did not direct IBC to pursue a lesser scope of work or attempt to negotiate any reduced scope with IBC. To the contrary, HCFA advised IBC that it could submit full cost and that such costs would be reimbursed in accordance with the Cost of Administration article.

As discussed above with regard to 1996, HCFA could not establish prejudice from any lack of notice with regard to 1997 (assuming, for purposes of argument only, that IBC did not strictly comply with Article VI(H)). HCFA also specifically agreed to reimburse allowable costs in excess of the amount set forth in the NOBA and thus may not rely on the NOBA to bar payment. *Johnson Controls*.

Finally, HCFA would be estopped from now relying on the Cost of Administration clause notice requirements to bar reimbursement after it induced IBC to continue



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performing with the knowledge that IBC had (or soon would) exceed the relevant NOBAs. See *American Electronic Labs., Inc. v. United States*, 774 F.2d 1110 (Fed. Cir. 1985). IBC acted in reliance on HCFA's direction to proceed with work. HCFA either intended that IBC rely upon its assurances with regard to reimbursement and/or IBC had reason to believe that HCFA wanted it to proceed with work. Under the circumstances, IBC did not have reason to believe HCFA would invoke (three years later) the notice provisions to avoid payment. Furthermore, HCFA received the benefit of the work that IBC performed.

Unfunded Transition Costs - \$497,697

The draft audit report questions this category of costs on the basis that IBC "did not submit a transition budget." Draft Audit Report at 10. The draft report further states that although IBC advised HCFA that it would exceed the NOBA for 1997, HCFA did not approve the additional funding.

As noted above, IBC repeatedly advised HCFA that it would exceed the NOBA and would cease work if HCFA did not authorize additional funding. In the course of doing so, IBC notified HCFA that transition efforts would cause it to exceed the NOBA. IBC provided periodic estimates of the amount of additional funds needed. HCFA did not direct IBC to cease transition work or demand submission of an SBR to address such transition efforts.

Pursuant to a June 26, 1997 letter from Gary Kavanagh of HCFA to IBC, IBC did not submit an SBR for the transition effort. (Attachment 4). As stated in this letter, HCFA informed IBC that all costs would be audited after completion of the contract. According to HCFA, if the audit showed that actual costs exceeded the budgeted amount, and the costs were reasonable and allowable, HCFA would pay the costs in accordance with Paragraph I of the Cost of Administration article. HCFA thus was apprised that IBC would exceed the budgeted amount and directed IBC to proceed with work. Pursuant to the Cost of Administration article, HCFA must reimburse IBC for such costs, as further discussed above.

Unsupported Cost - \$387,415 for 1996 & \$92,716 for Transition Cost

We disagree with several findings in this area, where it appears the draft audit report recommends disallowance based on a purported lack of documentation. The



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draft audit report even suggests that IBC declined to provide documentation. Draft Audit Report at 3, 10. This assertion is plainly inaccurate.

IBC supplied all documentation requested by the auditors to the extent it was available. We believe we provided sufficient documentation for the auditors to complete their fieldwork, as no additional documentation was requested. We recognize that in certain cases, supporting invoices could not be found or were illegible due to shortcomings in the then-existing microfilm system. We suggested in these cases that the auditors extend testing to other additional and similar invoices. The auditors did not do so. We respectfully submit that the reasonableness of these costs can be established by selecting an additional/alternative sample.

Furthermore, at the time of the auditors' departure, we understood that any outstanding items would have been requested through follow-up written correspondence from the audit team. When no such written correspondence was received, we assumed that sufficient documentation was supplied throughout the audit, and there were no substantive open issues. Based on some of the comments in the draft audit report, it appears that additional clarification is required. The following open issues are examples:

- 1) Cost associated with the all associate incentive plan and 401(K) contributions --
we provided the incentive guidelines and the method in which cost was allocated to product lines. If further documentation, such as specific payroll data is required, it will be supplied at your request.
- 2) Programmer and IS Mainframe chargebacks -- we don't understand this finding
since we explained the methodology to the auditors and were under the impression that the auditors understood the chargeback process.
- 3) Health Insurance -- IBC provided the method in which cost centers are prorated
their expense for health insurance. At the time of the audit, the auditors were given a copy of the journal entry to record the actual expense for the month in question. At that time, we explained that we could get a copy of the total invoices. The auditors responded, however, that they considered the bill to be too large, which indicated to IBC that the auditors had



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received sufficient data. Under the circumstances, therefore, we do not understand why the draft audit report raised this concern.

Again, we believe we covered these issues with the auditors. We have additional documentation and will make it available, if requested.

Salaries and Wages - \$13,807,820

In regard to claimed salaries, the draft audit report states that IBC "declined to provide payroll data necessary to complete (HCFA's) review." Draft Audit Report at 13. To the contrary, IBC provided enough documentation, based on past experience, for the auditors to complete their analysis. Data was submitted to the auditors in the same fashion as we have provided during the past audits and for other Government agencies in past reviews. Information supplied included: 1) Variance reports that show total salaries recorded for the month at the cost center level; 2) Detail Journal Reports showing actual payroll data being charged to the cost center; and 3) Human Resource Reports showing the names of employees in that cost center. Such information establishes that the claimed costs are allocable and reasonable. If further payroll-specific data is needed, however, it will be made available for review upon request.

Severance Payments - \$684,078

The draft audit report does not question severance costs because IBC had not yet claimed them as of the time the audit fieldwork was performed. Draft Audit Report at 13.

Severance pay is an allowable cost pursuant to FAR § 31.205-6(g). At the time of the audit, IBC was in the process of gathering data for the associates who received a severance package. Since the exact amount of severance package was not available, the cost was estimated at \$684,078, and was not included with IBC's filed cost. Based on discussion with the OIG, it was determined that severance should be based on actual time spent working on the Medicare program. Enclosed are copies of severance agreements and a work sheet showing the method of allocation used in order to come up with the actual expense of \$531,619.55 which is chargeable to the Medicare Program. (Attachment 5). This method establishes that Medicare will be allocated its fair share and that the costs are reasonable. Based on the enclosed documentation, we believe that we are entitled to the reimbursement of severance payments.



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Also, we have enclosed documentation in support of our claim for transition costs resulting from exiting the Medicare business as a fiscal intermediary. This documentation includes the letters, marked Attachments 2 & 3, between IBC Sr. Management and HCFA in which an agreement was reached to fund transition costs beyond budgeted amounts, subject to audit for reasonableness and allowability. We believe that this agreement, reached in the summer of 1997, acknowledges IBC's right to claim reimbursement for these transition costs without taking the further administrative step of submitting an SBR.

Conclusion

In sum, as shown by the discussion above and the attached additional documentation, the claimed costs questioned in the draft audit report are allowable and reasonable.

I understand that Dana Christian of your audit staff has contacted Ed Kelly of IBC regarding an exit conference, since one was not held at the completion of your fieldwork. Given the need for some additional clarification, once you have had the chance to review our response and the enclosed documentation, we would welcome the opportunity for your audit team to return for review and discussion of any additional data you feel is necessary in order to bring this audit to a reasonable close. Once all open issues are addressed, we would be happy to schedule an exit conference.

If you or your staff have any further questions, please feel free to call Ed Kelly directly at (215) 241-2560.

Sincerely,

A handwritten signature in black ink, appearing to read "John G. Foos".

John G. Foos
Chief Financial Officer

cc: Marcia G. Madsen, Esq.
Miller & Chevalier, Chtd.