

**Memorandum**

Date JAN 13 1994

From June Gibbs Brown
Inspector GeneralSubject Report on Medicare Part B Administrative Costs at Pennsylvania Blue Shield
(A-03-92-00035)To Bruce C. Vladeck
Administrator
Health Care Financing Administration

The purpose of this memorandum is to alert you to the issuance on January 14, 1994, of our final report. A copy is attached.

During the period October 1, 1987 through September 30, 1991, Pennsylvania Blue Shield (PBS) claimed \$327,508,851 for administering the Medicare Part B program. The audit showed that \$2,428,117 of the costs claimed were unallowable.

The Health Care Financing Administration (HCFA) contracted with PBS to administer the Medicare Part B program in Pennsylvania, New Jersey, Delaware, and the District of Columbia. Under the provisions of the contract, PBS is required to receive, disburse, and account for Federal funds in making payments for services furnished to eligible Medicare beneficiaries. The PBS' responsibilities also include making determinations as to coverage of services and reasonableness of charges, furnishing timely information and reports to HCFA, and maintaining records to ensure the correctness and verification necessary for the administration of the contract.

The PBS is entitled to reimbursement of all administrative costs claimed, provided that the provisions of the Medicare agreement have been met and that the costs were incurred in accordance with Federal regulations. Our review of PBS' accounting records showed that the majority of these costs were allowable and reimbursable under the terms of the contract. We noted, however, that PBS allocated \$2,428,117 of unallowable costs to the Medicare program.

The unallowable costs included \$1,299,419 for pension costs which we included in a previous audit report to PBS¹. These costs, therefore, are not included in the attached report. The remaining unallowable costs of \$1,128,698, which are the

¹ Review of Unfunded Pension Costs Pennsylvania Blue Shield CIN: A-03-93-00016 - August 13, 1993.

Page 2 - Bruce C. Vladeck

subject of this report, include costs associated with PBS' private lines of business, entertainment, contributions, a bid proposal, and other activities not eligible for Medicare reimbursement.

In this report, we recommend that PBS make procedural improvements and refund \$1,128,698 to the Medicare program. The PBS stated that procedural improvements were made and that \$1,128,698 would be refunded to the Medicare program. The PBS further stated, however, that it did not agree with all of our findings, and that it reserved the right to challenge some of the findings in its negotiations with HCFA. The Operating Division officials generally agreed in principle with the findings and recommendations contained in this report.

For further information, contact:

Thomas J. Robertson
Regional Inspector General
for Audit Services, Region III
(215) 596-6744

Attachment

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REPORT ON MEDICARE PART B
ADMINISTRATIVE COSTS AT
PENNSYLVANIA BLUE SHIELD**



JANUARY 1994 A-03-92-00035



DEPARTMENT OF HEALTH & HUMAN SERVICES

REGION III
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Our Reference: Common Identification Number A-03-92-00035

Mr. Samuel Ross
President
Pennsylvania Blue Shield
1800 Center Street
Camp Hill, Pennsylvania 17089

Dear Mr. Ross:

Enclosed for your information and use are two copies of an HHS/OIG Office of Audit Services report titled REVIEW OF MEDICARE ADMINISTRATIVE COSTS AT PENNSYLVANIA BLUE SHIELD FOR FISCAL YEARS 1988 THROUGH 1991. Your attention is invited to the audit finding and recommendations contained in the report.

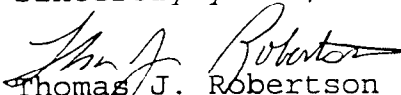
Final determination as to actions to be taken on all matters will be made by the HHS official named below. The HHS action official will contact you to resolve the issues in this audit report. Any additional comments or information that you believe may have a bearing on the resolution of this audit may be presented at that time. A copy of this report has been provided to the Blue Cross Association.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), the HHS/OIG Office of Audit Services 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 Section 5.71 of the Department's Public Information Regulation, dated August 1974, as revised.)

Page- 2 - Mr. Samuel Ross

To facilitate identification, please refer to the referenced common identification number in all correspondence relating to this report.

Sincerely yours,


Thomas J. Robertson
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to:

Mr. Dennis Carrol
Associate Regional Administrator
Division of Medicare
Health Care Financing Administration
Region III

SUMMARY

The Pennsylvania Blue Shield (PBS) claimed \$327,508,851 on its Final Administrative Cost Proposals (FACP) for the period October 1, 1987 through September 30, 1991 for work related to the processing of Part B Medicare claims. Our review of PBS' accounting records revealed that the majority of these costs were allowable and reimbursable under the terms of the contract. We noted, however, that PBS allocated \$2,428,117 of unallowable costs to the Medicare program. These costs consist of: (1) unallowable pension costs of \$1,299,419 that have been previously reported to PBS¹ and, therefore, are not included in this report; and (2) other unallowable costs of \$1,128,698 which are the subject of this report. These unallowable costs include:

- \$669,929 in costs related solely to PBS' private lines of business.
- \$130,257 for contributions and sponsorships of charitable events.
- \$71,193 for entertainment, including membership dues for private country clubs and social clubs.
- \$191,222 in proposal costs directly to Medicare.
- \$66,097 for miscellaneous items including outplacement services, limousine services and dues to lobbying organizations.

We recommend that PBS correct the procedural deficiencies noted in this review. We also recommend that PBS reduce its FACPs for Fiscal Years 1988 through 1991 by \$1,128,698.

On November 19, 1993, PBS responded to a draft of this report. The PBS agreed that certain private business costs and other unallowable costs were allocated to the Medicare program. The PBS also agreed, in an effort to expedite the Closing Agreement process, to refund \$1,128,698 to the Health Care Financing Administration. The PBS, however, retained the right to challenge some of the findings contained in this report, but did not identify those findings that it disagreed with.

We have summarized PBS' comments after the Conclusions and Recommendations section of this report and have included the comments in their entirety as an appendix.

¹

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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.

Medicare Part B is administered by the Health Care Financing Administration (HCFA) with the assistance of public or private organizations known as Carriers. Contracts are executed between HCFA and the Carriers to process Medicare Part B claims for designated geographical areas. The Pennsylvania Blue Shield (PBS) is a Carrier responsible for the receipt, review, audit, and payment of Medicare Part B claims submitted by providers of services in Pennsylvania, Delaware, New Jersey and the District of Columbia.

The PBS is reimbursed for its costs under the terms of the contracts with HCFA under the principle of neither profit or loss. The PBS is entitled to reimbursement of all allowable administrative costs claimed on the Final Administrative Cost Proposal (FACP), provided that the required provisions of the Medicare contract have been met. Appendix B of the contracts and referenced Federal regulations identify allowable administrative costs that may be reimbursed.

The HCFA and PBS also negotiate an annual budget for administrative costs. From October 1, 1987 through September 30, 1991, PBS incurred and claimed administrative costs of \$327,508,851 for processing Medicare Part B claims in excess of \$12.2 billion. As shown below, PBS' incurred and claimed costs did not exceed its total approved budget in any of the 4 years under review.

COMPARISON OF BUDGETED TO CLAIMED COSTS			
<u>Fiscal Year</u>	<u>Budgeted</u>	<u>Claimed</u>	<u>Over</u>
1988	\$ 53,181,471	\$ 53,181,471	\$ -0-
1989	80,044,697	80,044,697	-0-
1990	91,587,743	91,587,743	-0-
1991	<u>102,857,500</u>	<u>102,694,940</u>	<u>(162,560)</u>
Total	<u>\$327,671,411</u>	<u>\$327,508,851</u>	<u>\$(162,560)</u>

SCOPE OF AUDIT

Our audit was made in accordance with generally accepted government auditing standards. The primary objective of the audit was to determine whether PBS' FACPs for Fiscal Years (FYs) 1988 through 1991 presented fairly the allowable costs of administration in conformity with the reimbursement principles contained in Chapter 1, Part 31 of the Federal Acquisition Regulation (FAR), as interpreted and modified by the Medicare contracts and the Carrier Manual.

To accomplish our objective, we studied PBS' systems of internal control for the accounting and reporting of administrative costs incurred under the program, to the extent we considered necessary, to evaluate the systems and determine compliance with contractual and administrative requirements. For the purpose of this report, we have classified the significant internal accounting controls into the following categories: (1) Financial Reporting; (2) Accounts Payable; (3) Purchasing/Disbursements; (4) Indirect Costs/Cost Allocation Procedures; (5) Salaries and Wages; and (6) Fringe Benefits.

Our evaluation included all of the control categories listed above. Such a review, however, would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of PBS' Medicare Part B operations taken as a whole or on any of the categories identified above.

Our review disclosed that there was more than a relatively low risk that unallowable costs were being allocated to Medicare from PBS' corporate business units. As a result, we substantially expanded our testing of expenditures from those corporate cost centers that allocated costs to Medicare. During the audit period under review we tested the following number of invoices:

INVOICES TESTED		
<u>Fiscal Year</u>	<u>Invoices</u>	<u>Amount</u>
1988	1,335	\$ 2,916,772
1989	1,297	4,919,601
1990	1,624	3,997,214
1991	<u>1,863</u>	<u>4,257,502</u>
Total	<u>6,119</u>	<u>\$16,091,089</u>

In reviewing the allowability and allocability of costs, we considered whether the costs incurred were: (1) allowable;

(2) reasonable; (3) necessary to the overall operation of PBS; (4) benefitted Medicare; and (5) deemed to be assignable to Medicare in view of the provisions contained in the FAR, Medicare contracts, and the Carrier Manual. In reviewing the reasonableness of costs, we considered whether or not the individuals that caused the costs to be incurred acted with due prudence in the circumstances considering their responsibilities to PBS, its employees, the Federal Government and the public at large.

Our review was performed during the period September 1992 to May 1993 at PBS' offices in Camp Hill, Pennsylvania.

FINDINGS AND RECOMMENDATIONS

During the period October 1, 1987 through September 30, 1991, PBS claimed administrative costs totaling \$327,508,851. Based on the results of our review, we determined that PBS allocated costs totaling \$2,428,117 which were unallowable in accordance with applicable Federal regulations and the terms of the Medicare contract. We have previously recommended² that PBS stop claiming unfunded pension costs and refund \$1,299,419 of unallowable pension costs to the Medicare program. Therefore, the unallowable pension costs are not included in this report. The remaining \$1,128,698 of unallowable costs resulted from inadequate controls by PBS to prevent allocation of unallowable charges to the Medicare program.

UNALLOWABLE COSTS ALLOCATED TO MEDICARE

The PBS needed to improve its cost screening methodology to prevent the allocation of unallowable costs to the Medicare program. The PBS cost accounting system captures expenditures and utilizes a full absorption costing method to allocate these costs to the various lines of business, including Medicare. However, adequate measures were not always taken to assure that only allowable costs were included in the costs to be allocated to Medicare.

As a result, PBS included \$3,617,645 of unallowable costs for allocation of which \$1,128,698 was allocated to the Medicare program as shown below.

² Review of Unfunded Pension Costs Pennsylvania Blue Shield
CIN: A-03-93-00016 August 13, 1993

UNALLOWABLE COSTS		
<u>Fiscal Year</u>	<u>Total</u>	<u>Allocated to Medicare</u>
1988	\$ 771,118	\$ 177,932
1989	780,905	357,015
1990	981,601	279,948
1991	<u>1,084,021</u>	<u>313,803</u>
Total	<u>\$3,617,645</u>	<u>\$1,128,698</u>

The unallowable costs include:

- \$2,560,480 (\$669,929 allocated to Medicare) for purposes that related solely to PBS' private lines of business.
- \$450,730 (\$130,257 allocated to Medicare) for contributions and sponsorships of charitable events.
- \$222,906 (\$71,193 allocated to Medicare) for entertainment expenses including dues to private country clubs and social clubs.
- \$195,000 (\$191,222 allocated to Medicare) for costs of a bid proposal.
- \$188,529 (\$66,097 allocated to Medicare) for miscellaneous items.

Private Business Expenses

The PBS allocated \$669,929 to Medicare for costs related solely to PBS' subsidiaries or their private lines of business. This allocation was based on expenditures totaling \$2,560,480 from PBS' corporate cost centers.

Section 31.202 (a) of the FAR states:

A direct cost is any cost that can be identified specifically with a final cost objective... Costs identified specifically with the contract are direct costs of the contract and are to be charged directly to the contract. All costs specifically identified with other final cost objectives of the contract are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly.

Our review revealed that PBS did not always assign the proper cost allocation codes to expenditures in the corporate cost centers. The PBS' cost allocation system is a highly complex

and dynamic process that allows expenditures to be assigned by various methods including: final line of business, combination line of business or cost center allocation ratio. We found that costs in the corporate cost centers were assigned a 000 code regardless of their relationship to individual lines of business. The 000 code resulted in these costs being allocated to all lines of business. Therefore, expenditures which were directly related to PBS' private lines of business were included for allocation to the Medicare program.

As shown below, PBS included for allocation \$2,560,480 for costs that were assignable to private lines of business, of which \$669,929 was allocated to Medicare. These costs were identifiable with PBS' non Medicare lines of business and, therefore, were not eligible for allocation to the Medicare contract. The unallowable costs included:

- \$852,636 (\$234,468 allocated to Medicare) for publications, graphic arts and photography services. Examples of these types of costs include marketing claims kits and sales literature publications for PBS' private accounts; private line of business publications such as Dental Newsletters, Provider Review Newsletters (PBS physicians) and Opti-Choice brochures.
- \$483,510 (\$116,561 allocated to Medicare) for legal and private consultants engaged for projects such as anti-trust litigation, legal work for subsidiary corporations, valuation studies of a potential subsidiary's assets and sales training seminars.
- \$475,862 (\$129,426 allocated to Medicare) in advertising and marketing expenses such as public relation survey reports, customer service surveys (private business), advertising and media relations for PBS' Our Doctors are Priceless and Participating Doctor campaigns.
- \$165,908 (\$40,106 allocated to Medicare) for audio visual services related to PBS' private lines of business.
- \$130,438 (\$47,960 allocated to Medicare) in employment-related placement fees for top level executive positions in PBS subsidiary corporations.
- \$452,126 (\$101,408 allocated to Medicare) for other private line of business expenses such as Blue Cross and Blue Shield Association fees, PBS participation in a Pennsylvania state-wide health data base,

mailing costs for private business publications, promotional merchandise as well as private meeting and travel expenses.

The PBS officials agreed that expenditures in the corporate cost centers were improperly coded, and that the costs should have been assigned to the direct lines of business.

Charitable Contributions

The PBS allocated \$130,257 to Medicare for unallowable charitable contributions and sponsorships totaling \$450,730 in FYs 1988 through 1991.

Section 31.205-8 of the FAR states:

... that contributions or donations, including cash, property and services, regardless of recipient, are unallowable, except as provided in 31.205-1(e)(3).

This section allows the costs of participation in community services activities, such as blood drives, charity drives, savings bond drives and so on. It does not allow charitable donations. The unallowable costs included:

- \$154,500 (\$52,311 allocated to Medicare) to the regional United Way Campaign.
- \$15,000 (\$4,247 allocated to Medicare) to a sports foundation to sponsor the Grand Masters of Olympic Wrestling tournament.
- \$14,400 (\$1,689 allocated to Medicare) to the American Heart Association in sponsorship of the Governor's Cup Triathlon.
- \$8,400 (\$2,176 allocated to Medicare) for sponsorship of two Pennsylvania high school football tournaments.
- \$6,170 (\$2,468 allocated to Medicare) to the Art Association of Harrisburg;
- \$1,500 (\$216 allocated to Medicare) to the Harrisburg Symphony Association;
- \$1,000 (\$234 allocated to Medicare) to the National Italian Sports Hall of Fame.
- \$249,760 (\$66,916 allocated to Medicare) of other charitable contributions.

Entertainment

The PBS allocated \$71,193 to Medicare for what we consider to be entertainment expenses totaling \$222,906.

The FAR S31.205-14 states:

Costs of amusement, diversion, social activities, and any directly associated costs such as tickets to shows or sports events...are unallowable. Costs of memberships in social, dining, or country clubs or other organizations having the same purpose are also unallowable...

The unallowable entertainment expenses included:

- \$71,521 (\$26,564 allocated to Medicare) for memberships in private country clubs, and social clubs.
- \$28,257 (\$8,696 allocated to Medicare) for costs associated with retirement dinners for a Chairman of the Board and a Vice President.
- \$22,971 (\$5,920 allocated to Medicare) for a Board of Directors dinner.
- \$20,251 (\$8,111 allocated to Medicare) for tickets and drink charges at professional football and baseball games.
- \$16,885 (\$5,054 allocated to Medicare) for an annual dinner meeting.
- \$1,280 (\$394 allocated to Medicare) for concert tickets.
- \$612 (\$184 allocated to Medicare) for a Board of Directors golf outing.
- \$61,129 (\$16,270 allocated to Medicare) for other entertainment expenses.

Proposal Costs

The PBS allocated \$191,222 to Medicare for bid and proposal costs totaling \$195,000. The bid and proposal costs related to PBS' unsuccessful attempt to become a host site for Medicare's Common Working File (CWF).

The CWF is a computer software project which allows Medicare contractors to make Medicare eligibility determinations at host

locations rather than HCFA making the determinations through the existing centralized process. The HCFA Central Office issued invitations to bid on the host site for CWF in March 1989. The PBS contracted the bid proposal to a private consultant for \$195,000. The price of the contract was charged to government business unit cost center 322 "Director, Medicare Staff and Systems Services." Cost center 322 allocated \$191,222 of the \$195,000 to the Medicare contract.

In our opinion, the CWF proposal costs are unallowable for allocation to the Medicare contract since the costs do not meet the provisions contained in FAR 31.204-4, which state:

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship...a cost is allocable to a Government contract if it--

(a) Is incurred specifically for the contract;

(b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or

(c) Is necessary to the overall operation of the business...

As a result of the CWF proposal costs not meeting any of the above criteria, we believe that the \$191,222 charged to Medicare represents an unallowable cost.

Miscellaneous Costs

The PBS allocated \$66,097 to Medicare for miscellaneous unallowable costs totaling \$188,529. These costs include:

- \$46,100 (\$18,226 allocated to Medicare) for outplacement services fees for fired PBS executives.
- \$43,111 (\$17,352 allocated to Medicare) for a special 50th anniversary event.
- \$41,233 (\$12,531 allocated to Medicare) for local staff meetings.
- \$17,894 (\$5,105 allocated to Medicare) for dues to lobbying organizations.
- \$4,100 (\$1,204 allocated to Medicare) for limousine services for the President of PBS.

- \$36,091 (\$11,679 allocated to Medicare) for other miscellaneous costs.

Conclusions and Recommendations

Our review of administrative costs claimed by PBS for FYs 1988 through 1991 showed that PBS did not adequately screen unallowable costs totaling \$3,617,645 (does not include unallowable pension costs which was the subject of a previous report) from being allocated to the Medicare program. As a result, PBS allocated unallowable costs of \$1,128,698 to the program.

We, therefore, recommend that PBS:

1. Strengthen its cost allocation system to assure that unallowable costs, including the type identified in this report, are not allocated to the Medicare program.
2. Reduce the FYs 1988 through 1991 FACPs by \$1,128,698.

PBS Response

On November 19, 1993, PBS responded to a draft of this report. The PBS agreed that private business costs and other unallowable costs were improperly allocated to the Medicare program. The PBS stated that it has taken the necessary action to strengthen cost allocation procedures to ensure that these types of costs are not allocated to the program in the future, and would refund to HCFA the \$1,128,698 identified in the report.

The PBS further stated that it did not concur with the total dollar amount of the findings, and reserved the right to challenge some of the findings upon issuance of the final report. The PBS did not, however, identify those findings that it disagreed with.



Medicare

November 19, 1993

Mr. Thomas J. Robertson
Regional Inspector General for Audit Services
Department of Health and Human Services
3535 Market Street
Philadelphia, PA 19104

Re: Common Identification
Number A-03-92-00035

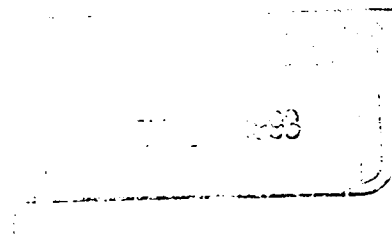
Dear Mr. Robertson:

The purpose of this letter is to provide Pennsylvania Blue Shield's comments regarding the Office of Audit Services' draft report entitled "Review of Medicare Administrative Costs Pennsylvania Blue Shield Fiscal Years 1988 through 1991."

We have reviewed the audit report findings and recommendations in detail and concur with those which identify clerical errors made in our Cost Allocation Department. As a result, certain private business costs were incorrectly allocated to Medicare as well as some items which are unallowable under the Medicare contract and the Federal Acquisition Regulations.

Pennsylvania Blue Shield has taken the necessary actions to improve its internal controls to strengthen cost allocation procedures to ensure that private business and unallowable costs are not allocated to the Medicare program.


In an effort to expedite the Closing Agreement process for these years, Pennsylvania Blue Shield will promptly refund to HCFA the \$1,128,698 identified in the draft report as the total unallowed costs allocated to the contract. However, we do not concur with the total dollar amount of the findings in the draft audit. Although Pennsylvania Blue Shield will return this amount to HCFA, Pennsylvania Blue Shield reserves the right to challenge some of the findings contained in the report. We will, upon issuance of the final audit report, bring these matters to the attention of the Health Care Financing Administration Regional Office.



Mr. Thomas J. Robertson
Page Two
November 19, 1993

Thank you for the opportunity to comment on the draft audit report. Should you have any questions concerning this response, please call me at (717) 763-3919.

Sincerely,


Everett F. Bryant
Senior Vice President
Government Business

EFB/jmb

cc: Maurice Hartman