



SEP 19 2005

Office of Audit Services
Region I
John F. Kennedy Federal
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Room 2425
Boston, MA 02203
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Report Number: A-01-05-00509

Mr. David Fogerty
Director of Government Operations
Blue Cross & Blue Shield of Rhode Island
444 Westminster Street
Providence, Rhode Island 02903

Dear Mr. Fogerty:

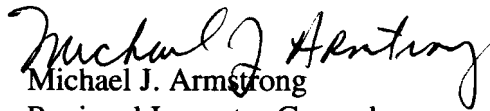
Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General report entitled "Review of Medicare Contract Severance and Termination Costs Claimed by Blue Cross & Blue Shield of Rhode Island for February–December 2004." A copy of this report will be forwarded to the action official noted below for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. 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, 5 U.S.C. § 552, as amended by Public Law 104-231, Office of Inspector General reports are made available to members of the press and general public to the extent that information contained therein is not subject to exemptions in the Act that the department chooses to exercise (see 45 CFR Part 5).

Questions on any aspect of the report are welcome. Please refer to report number A-01-05-00509 in all correspondence.

Sincerely,


Michael J. Armstrong
Regional Inspector General
for Audit Services

Enclosures – as stated

Page 2 – Mr. David Fogerty

Direct Reply to HHS Action Official:

Charlotte S. Yeh, M.D.
Regional Administrator
Centers for Medicare & Medicaid Services – Region I
Department of Health and Human Services
JFK Federal Building, Room 2325
Boston, Massachusetts 02203

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF MEDICARE
SEVERANCE AND TERMINATION
COSTS CLAIMED BY BLUE CROSS &
BLUE SHIELD OF RHODE ISLAND
FOR FEBRUARY–DECEMBER 2004**



DANIEL R. LEVINSON
Inspector General

SEPTEMBER 2005
A-01-05-00509

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
at <http://oig.hhs.gov>

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR Part 5.)

OAS FINDINGS AND OPINIONS

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



EXECUTIVE SUMMARY

BACKGROUND

The Medicare program is administered by the Centers for Medicare & Medicaid Services (CMS). CMS contracts with private organizations, known as intermediaries for Part A and carriers for Part B, to process and pay claims for services provided to eligible beneficiaries. CMS contracted with Blue Cross & Blue Shield of Rhode Island (Rhode Island) to serve as the Part A intermediary and Part B carrier responsible for processing all Part A and Part B claims in Rhode Island.

In June 2003, Rhode Island exercised its contractual option to terminate its participation as a Medicare contractor and notified CMS accordingly. Both Rhode Island and CMS agreed that this termination would be effective January 31, 2004. CMS agreed to reimburse Rhode Island for allowable, allocable, and reasonable severance and termination costs incurred in closing out the Medicare contracts.

The company claimed \$5,521,621 in severance and termination costs for reimbursement through December 31, 2004. Of this amount, \$3,803,345 in pensions and post retirement health benefits was referred to Office of Inspector General Region VII for a separate review. As a result, our review was limited to the remaining \$1,718,276 in severance and termination costs that Rhode Island claimed for reimbursement through December 31, 2004.

OBJECTIVE

Our objective was to determine whether the severance and termination costs that Rhode Island claimed are allowable, allocable, and reasonable, in accordance with Medicare contract provisions, Federal regulations, and company policies.

SUMMARY OF FINDINGS

From February 1, 2004, through December 1, 2004, Rhode Island claimed \$205,474 in severance and termination costs that were not allowable for Medicare reimbursement as follows:

- \$133,286 for unallowable overhead and general and administrative costs;
- \$36,919 for consultant costs claimed in excess of actual paid invoices;
- \$18,439 for unallowable depreciation and asset write-off costs; and
- \$16,830 for property taxes in excess of actual costs incurred.

Rhode Island made these unallowable claims because it did not have adequate internal control procedures to ensure that costs were claimed in accordance with the regulations for determining the allowability of contract costs as set forth in the Federal Acquisition Regulations (FAR). As a result, Rhode Island overstated its claim for Medicare reimbursement by a total of \$205,474.

RECOMMENDATIONS

We recommend that Rhode Island:

- reduce its claim for overhead and general and administrative termination costs by \$133,286 for costs claimed in excess of the approved amounts (see Appendix B), and
- reduce its termination costs by \$13,257 for part of the depreciation and write-off losses claimed on Medicare assets in excess of amounts allowed (see Appendix B).

As a result of our review, Rhode Island has submitted a subsequent termination voucher to deduct the \$36,919 for consultant costs that were in excess of actual amounts spent, \$16,830 in overstated property taxes, and \$5,182 for part of the depreciation and write-off losses claimed on Medicare assets in excess of amounts allowed. Therefore, we do not have any further recommendations related to these findings. However, CMS should consider these adjustments in the final settlement of these termination vouchers (see Appendix B).

BLUE CROSS & BLUE SHIELD OF RHODE ISLAND'S COMMENTS

In its August 23, 2005, written response to our draft report (see Appendix C), Rhode Island agreed with the recommended disallowances of \$133,286 for overhead and general and administrative costs claimed in excess of approved amounts, \$36,919 for consultant costs claimed in excess of actual amounts spent, \$16,830 in overstated property taxes, and \$6,415 in depreciation and write-off losses claimed in excess of amounts allowed. However, Rhode Island disagreed with our recommendations that \$12,024 of the depreciation and write-off loss and \$7,046 for depreciation and property taxes on non-Medicare office equipment should be disallowed.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

After our review of Rhode Island's response and the accompanying documentation, we have deleted our finding of \$7,046 for depreciation and property taxes on non-Medicare office equipment. However, we maintain that our recommended disallowance of depreciation and write-off losses accurately reflect Rhode Island's failure to comply with applicable Federal regulations and Medicare program criteria. As a result, we continue to believe that this recommended financial adjustment is warranted.

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INTRODUCTION

BACKGROUND

Medicare Program

Title XVIII of the Social Security Act (the Act) established the Health Insurance for the Aged and Disabled (Medicare) Program. Medicare is a national health insurance program that provides coverage to eligible beneficiaries age 65 and over, some beneficiaries under 65 with disabilities, and beneficiaries with end-stage renal disease. This program has two distinct parts. Part A is the hospital insurance program, which provides coverage of inpatient hospital care, posthospital extended care, and posthospital home health care. Part B is an optional medical insurance program that covers physician services, hospital outpatient services, home health care, and other health services.

The Medicare program is administered by the Centers for Medicare & Medicaid Services (CMS). CMS contracts with private organizations, known as intermediaries for Part A and carriers for Part B, to process and pay claims for services provided to eligible beneficiaries. The Act provides for reimbursing intermediaries and carriers for all reasonable and allowable costs incurred in administering the programs.

Blue Cross & Blue Shield of Rhode Island Medicare Contracts

Blue Cross & Blue Shield of Rhode Island (Rhode Island) contracted with CMS to serve as the Medicare Part A intermediary and Part B carrier responsible for processing all Part A and Part B claims in Rhode Island.

In July 2003, Rhode Island exercised its contractual option to terminate its participation as a Medicare contractor and notified CMS accordingly. Both Rhode Island and CMS agreed that this termination would be effective January 31, 2004. Under the termination agreement, CMS agreed to reimburse Rhode Island for reasonable, allowable, and allocable termination costs that the company incurred in transferring its responsibilities to other contractors. Rhode Island was to claim all termination costs in accordance with Federal Acquisition Regulation (FAR) 31.205-42 and provisions of the contracts and all severance costs in accordance with FAR 31.205-6 (g) and the company's established severance benefits policies.

Rhode Island is submitting periodic vouchers to CMS as severance and termination costs are incurred. The company claimed \$5,521,621 in severance and termination costs for reimbursement through December 31, 2004. Rhode Island will continue to submit claims for these costs as the remaining Medicare operations are closed down, but for the most part, these additional costs will be negligible.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether the severance and termination costs that Rhode Island claimed are allowable, allocable, and reasonable, in accordance with Medicare contract provisions, Federal regulations, and company policies.

Scope

From February 1, 2004, through December 31, 2004, Rhode Island submitted nine vouchers for reimbursement of severance and termination costs. These claims totaled \$5,521,621, of which \$3,803,345 was for pension and postretirement health costs. The pension and postretirement health costs are being reviewed by personnel from the Office of Inspector General Region VII, and the results will be reported separately. Therefore, the scope of our review was limited to the remaining \$1,718,276 in severance and termination costs claimed.

We reviewed Rhode Island's internal controls to obtain an understanding of company accounting policies and procedures.

This audit was performed in conjunction with our audit of the Medicare Final Administrative Cost Proposals submitted by Rhode Island for the period October 1, 1999, through January 31, 2004. The results of this administrative cost audit are in our Audit Report Number A-01-04-00523. Certain information obtained and reviewed during that audit was also used in performing this audit.

We performed our fieldwork at the Blue Cross & Blue Shield of Rhode Island offices in Providence, Rhode Island, from February 2005 through June 2005. In addition, we communicated with CMS officials in the Boston, Massachusetts, regional office throughout the course of the audit.

Methodology

To accomplish our audit objective, we reconciled the termination vouchers with the company's accounting records and reviewed direct charges, payroll documents, and the basis for allocating certain indirect costs. In reviewing selected costs, we considered whether costs claimed by Rhode Island were allowable, allocable, reasonable, adequately supported, and directly related to the Medicare program.

We conducted our review in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

From February 1, 2004, through December 31, 2004, Rhode Island claimed \$205,474 in severance and termination costs that were not allowable for Medicare reimbursement as follows:

- \$133,286 for unallowable overhead and general and administrative costs;
- \$36,919 for consultant costs claimed in excess of actual paid invoices;
- \$18,439 for unallowable depreciation and asset write-off costs; and
- \$16,830 for property taxes in excess of actual costs incurred.

Rhode Island made these unallowable claims because it did not have adequate internal control procedures to ensure that costs were claimed in accordance with the regulations for determining the allowability of contract costs as set forth in FAR. As a result, Rhode Island overstated its claim for Medicare reimbursement by a total of \$205,474 (\$73,971 Part A and \$131,503 Part B).

Appendix B provides a detailed breakout of all recommended adjustments.

OVERHEAD AND GENERAL AND ADMINISTRATIVE COSTS

Rhode Island claimed \$366,321 for overhead and general and administrative costs on its termination vouchers for February through December 2004. It calculated this amount by applying monthly overhead rates to total monthly termination costs. These rates represented the ratio of year-to-date Medicare direct expenses to company direct expenses and ranged from 12 percent to 29 percent. CMS informed us that Rhode Island should have used the interim expenditure rate of 18.31 percent for overhead and general and administrative costs that was in effect when the contract was terminated.

Using the CMS instructions, we recalculated the allowable costs and determined that Rhode Island's claims for overhead and general and administrative costs exceeded the allowable amount by \$133,286.

Rhode Island indicated that it had used its own allocation method because the interim expenditure rate did not compensate sufficiently for senior executives, who support all divisions, including Medicare.

CONSULTANT SERVICES

Pursuant to FAR Part 31.201-2(d), "A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles"

Rhode Island claimed \$36,919 for consultant costs on its termination vouchers that were in excess of actual amounts spent, as documented by invoices. Rhode Island inadvertently claimed duplicate reimbursement for a consultant's invoices totaling \$27,919 on the April and May vouchers. It also claimed \$9,000 in accrual amounts that it had not actually spent. Rhode Island officials agreed with these findings and removed these costs in a subsequent termination voucher submitted for January through March 2005.

DEPRECIATION AND ASSET WRITE-OFF COSTS

FAR Part 31.205-16 states, "The gain or loss for each asset disposed of is the difference between the net amount realized . . . and its undepreciated balance."

Rhode Island claimed reimbursement of \$393,060 for depreciation and loss on disposal of Medicare assets. Rhode Island officials stated that all Medicare assets were either written off or donated to charity. Because no amounts were realized on the disposal of any Medicare assets, Rhode Island should have claimed the undepreciated balance of Medicare assets as of January 31, 2004, when it terminated its Medicare contracts. We determined that this undepreciated balance was \$374,621.

As a result, Rhode Island claimed \$18,439 in excess of actual allowable depreciation and write-off losses on Medicare assets on its termination vouchers submitted from February through December 2004. This overclaim occurred because Rhode Island did not have controls in place to ensure that its termination vouchers were supported by adequate documentation that the costs claimed had been incurred and were allocable to the Medicare contract.

PROPERTY TAX

FAR Part 31.201-2(d) states, "A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles"

Rhode Island claimed \$33,754 for property taxes on termination vouchers submitted from February through December 2004. We determined that the actual amount incurred and allocable to Medicare was \$16,924.

When Rhode Island switched to a new accounting method in 2004, it inadvertently charged Medicare for property taxes under both the old and new methods. As a result, property taxes were overstated by \$16,830 on the termination vouchers that we reviewed. Rhode Island officials agreed and removed these costs in a subsequent termination voucher submitted for January through March 2005.

NON-MEDICARE OFFICE EQUIPMENT

In our draft report, we stated that Rhode Island claimed \$7,046 on termination vouchers submitted from February through December 2004 for unallowable depreciation and property tax for equipment not related to its Medicare operations.

As a result of Rhode Island's response and the additional support provided, we have deleted our finding of \$7,046 for depreciation and property taxes on non-Medicare office equipment.

RECOMMENDATIONS

We recommend that Rhode Island:

- reduce its claim for overhead and general and administrative termination costs by \$133,286 for costs claimed in excess of the approved amounts (see Appendix B), and
- reduce its termination costs by \$13,257 for part of the depreciation and write-off losses claimed on Medicare assets in excess of amounts allowed (see Appendix B).

As a result of our review, Rhode Island has submitted a subsequent termination voucher to correct the \$36,919 for consultant costs that were in excess of actual amounts spent, \$16,830 in overstated property taxes, and \$5,182 for part of the depreciation and write-off losses claimed on Medicare assets in excess of amounts allowed. Therefore, we do not have any further recommendations related to these findings. However, CMS should consider these adjustments in the final settlement of these termination vouchers (see Appendix B).

BLUE CROSS & BLUE SHIELD OF RHODE ISLAND'S COMMENTS

In its August 23, 2005, written response to our draft report (see Appendix C), Rhode Island agreed with the recommended disallowances of \$133,286 for overhead and general and administrative termination costs claimed in excess of the approved amounts, \$36,919 for consultant costs that were in excess of actual amounts spent, \$16,830 in overstated property taxes, and \$6,415 (\$5,182 and \$1,233) for part of the depreciation and write-off losses claimed on Medicare assets in excess of amounts allowed. However, with respect to the remaining recommended disallowances of \$12,024 of the depreciation and write-off loss and \$7,046 for depreciation and property taxes on non-Medicare office equipment, Rhode Island disagreed that these costs were not appropriate and allowable Medicare costs.

Depreciation and Asset Write-off Costs

Of the \$18,439 in depreciation and asset write-off losses that we recommended disallowing, \$12,024 was for idle facility costs. In support of this claim, Rhode Island cited FAR 31.205-17(c), which states:

Costs of idle capacity are costs of doing business and are a factor in the normal fluctuations of usage or overhead rates from period to period. Such costs are allowable provided the capacity is necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire plant or among a group of assets having substantially the same function may be idle facilities.

Rhode Island asserted that the cost in question was for space vacated by the Medicare Finance unit in an owned facility. This space was vacant for a period of several months until it could be reconfigured for use by another department. Therefore, Rhode Island maintained that the \$12,024 claimed for idle facility costs was allowable.

Non-Medicare Office Equipment

Rhode Island stated that the audit staff disallowed the depreciation and property taxes claimed on office equipment under the belief that the equipment was purchased for use by a non-Medicare department. However, it pointed out that the equipment was purchased by its wholly owned subsidiary, Coordinated Health Partners, for use by the Medicare Audit and Reimbursement department, which was part of the subsidiary. Rhode Island provided documentation to the audit staff at the exit conference that supports the allowability of the charge.

Rhode Island stated that it elected to store the equipment for future use in hopes of limiting the cost to the government. It maintained that the costs for depreciation and property taxes that it has claimed to date are less than the cost of the depreciation that it would have been entitled to claim if it had merely disposed of the asset.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

The \$12,024 depreciation and asset write-off cost that Rhode Island claimed as idle facility costs does not meet the definition of idle facilities. Pursuant to FAR 31.205-17(a), idle facilities are defined as completely unused facilities that are excess to the contractor's current needs. The partially vacated space on the sixth floor of One Empire Building created by the departure of the Medicare Finance unit does not meet the definition of a completely unused facility. One Empire, including parts of the sixth floor, continued to be used in the performance of Empire's commercial business. Furthermore, CMS previously denied these costs during its review and payment of termination vouchers for February through May 2004. CMS stated that lease abandonment costs of \$12,024 are unallowable as idle facility costs since the facility itself is not completely idle and is used in the performance of other Rhode Island contracts. Accordingly, we

stand by our recommended disallowance of \$12,024 as unallowable depreciation and asset write-off costs.

As a result of Rhode Island's response and the additional support provided, we have deleted our finding of \$7,046 for depreciation and property taxes on non-Medicare office equipment.

APPENDIXES

APPENDIX A

BLUE CROSS & BLUE SHIELD OF RHODE ISLAND
Severance and Termination Costs Claimed
February 2004 - December 2004

<u>Cost Category</u>	<u>Total Costs Claimed</u>	<u>Part A Share of Claimed Costs</u>	<u>Part B Share of Claimed Costs</u>
Salaries	\$508,415	\$183,029	\$325,386
Fringe Benefits	44,356	15,968	28,388
Consultant Services	353,857	127,389	226,468
Depreciation & Asset Writeoff Costs	397,232	143,004	254,228
Property Taxes	33,685	12,127	21,558
Office Supplies and Postage	8,614	3,101	5,513
Phone	1,511	544	967
Rent	4,285	1,543	2,742
Overhead and G&A Costs	366,321	131,876	234,445
Total Costs Claimed	\$1,718,276	\$618,581	\$1,099,695
OIG Recommended Disallowance *	205,474	73,971	131,503
OIG Recommended for Acceptance	<u>\$1,512,802</u>	<u>\$544,610</u>	<u>\$968,192</u>

* See APPENDIX B

APPENDIX B

BLUE CROSS & BLUE SHIELD OF RHODE ISLAND OFFICE OF INSPECTOR GENERAL'S RECOMMENDED DISALLOWANCES OF SEVERANCE AND TERMINATION COSTS CLAIMED

<u>Finding Categories</u>	<u>Total Recommended Disallowance</u>	<u>Total Part A Recommended Disallowance</u>	<u>Total Part B Recommended Disallowance</u>	<u>See Page</u>
OVERHEAD AND G&A COSTS	\$133,286	\$47,983	\$85,303	3
CONSULTANT SERVICES	36,919	13,291	23,628	3
DEPR. & ASSET WRITEOFFS	18,439	6,638	11,801	4
PROPERTY TAX	16,830	6,059	10,771	4
TOTAL DISALLOWANCES	<u>\$205,474</u>	<u>\$73,971</u>	<u>\$131,503</u>	

August 23, 2005

Mr. Michael Armstrong
Office of Audit Services
Region I
John F. Kennedy Federal Building
Room 2425
Boston, MA. 02203

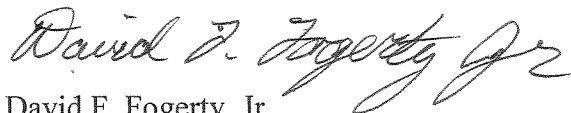
Dear Mr. Armstrong:

Blue Cross Blue Shield of Rhode Island has reviewed the draft audit report entitled "Review of Medicare Contract Severance and Termination Costs Claimed for February-December 2004-Blue Cross & Blue Shield of Rhode Island (Report A-01-05-00509)"

We disagree with the findings titled "Depreciation and Asset Write-Offs" and "Non-Medicare Office Equipment." The reasons for our disagreement are set forth in our enclosed response to the audit findings.

I am available to discuss our response or answer any questions that you might have. I can be reached at (401) 459-1956.

Sincerely,



David F. Fogerty, Jr.
Assistant Vice President
Budgets & Cost Analysis

cc: Robert Champagne
David Clinton

Overhead

BCBSRI agrees that it submitted termination vouchers in February, March and April of 2004 that calculated overhead using a methodology that was different than what was ultimately agreed to with CMS. All expenses claimed after April 2004 used the approach specified by CMS.

BCBSRI will submit a termination voucher to decrease our overhead claim by \$133,286.

Consultant Services

Blue Cross & Blue Shield of Rhode Island (BCBSRI) agrees that the termination vouchers submitted in 2004 included an overcharge of \$36,919. BCBSRI uncovered this error during reconciliation at the end of the year and submitted a credit on our March 2005 voucher.

Depreciation and Asset Write-off Costs

The \$18,439 referenced in this finding is comprised of the following:

- Idle Facility costs (\$12,024)
- Software Maintenance Fee (\$5,182)
- Other Depreciation (\$1,233)

The audit work papers identify \$12,024 of the disallowance as the cost claimed for idle facilities. The Federal Acquisition Regulations (31.205-17(c)) states:

Costs of idle capacity are costs of doing business and are a factor in the normal fluctuations of usage or overhead rates from period to period. Such costs are allowable provided the capacity is necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire plant or among a group of assets having substantially the same function may be idle facilities.

The cost in question was for space vacated by the Medicare Finance unit in an owned facility. This space was vacant for a period of several months until it could be reconfigured for use by another department. Therefore, we assert that these costs are allowable.

The 2004 termination claim included a software maintenance charge of \$5,182. BCBSRI agrees that this charge was an ongoing Medicare expense (not termination) and submitted a credit on our March 2005 voucher.

BCBSRI agrees that the asset write-off should be reduced by \$1,233.

Property Tax

As stated in the audit finding BCBSRI changed the method of accounting for property taxes and inadvertently charged Medicare under the new and old methods. BCBSRI staff recognized this inequity and submitted a correcting entry on our March 2005 voucher.

Non-Medicare Office Equipment

We disagree with this finding.

The audit staff disallowed the expense under the belief that the equipment was purchased for use by a non-Medicare department. The equipment was purchased by our wholly owned subsidiary Coordinated Health Partners, for use by the Medicare Audit and Reimbursement department (the department was part of the subsidiary). Documentation was provided to the audit staff at the exit conference that supports the allowability of the charge.

BCBSRI elected to store the equipment for future use in hopes of limiting the cost to the government. To date we have charged costs for depreciation and property taxes which is less than the costs that would have been charged to dispose of the asset.