

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF BLUE CROSS  
BLUE SHIELD ASSOCIATION  
FINAL ADMINISTRATIVE COST  
PROPOSALS FOR FISCAL YEARS 2010  
THROUGH 2015**

*Inquiries about this report may be addressed to the Office of Public Affairs at  
[Public.Affairs@oig.hhs.gov](mailto:Public.Affairs@oig.hhs.gov).*



Gloria L. Jarmon  
Deputy Inspector General  
for Audit Services

March 2017  
A-05-15-00056

# ***Office of Inspector General***

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## **OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS**

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

## INTRODUCTION

*The Blue Cross Blue Shield Association final administrative cost proposals for fiscal years 2010 through 2015 were generally reasonable, allowable, and allocable and in compliance with Federal regulations. However, we identified \$174,000 in unspent termination funds, a severance benefit overpayment, and unallowable costs that should be refunded to CMS.*

### WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) contracted with the Blue Cross Blue Shield Association (BCBSA) to be the prime fiscal intermediary for the Medicare Part A program. CMS requested that we audit BCBSA's Medicare final administrative cost proposals (FACPs) for Federal fiscal years (FYs) 2010 through 2015 because the contract expired September 30, 2015. In addition, we also reviewed transition and termination costs incurred before and after the contract expired.

### OBJECTIVES

Our objectives were to determine whether (1) the BCBSA cost proposals for FYs 2010 through 2015 presented fairly the costs of program administration and (2) the costs were reasonable, allowable, and allocable and in accordance with the Federal Acquisition Regulation (FAR) and other applicable criteria.

### BACKGROUND

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled (Medicare) program, which provides for a hospital insurance program (Part A) and a related supplementary medical insurance program (Part B). CMS administers the Medicare program through contracts with private organizations (contractors).

CMS contracts provide for the reimbursement of allowable administrative costs. In claiming costs, contractors must follow cost reimbursement principles contained in the FAR and the Medicare contracts. After the close of each FY, contractors submit to CMS an FACP reporting Medicare costs. Once CMS accepts an FACP, the contractor and CMS negotiate a final settlement of allowable administrative costs.

Before the contracts expire, contractors are allowed to incur transition costs that relate to the transfer of its Medicare files, records, and workload upon the expiration of the contract. Termination costs are incurred after the contract expires. Termination costs include, for example, severance pay, other forms of personal compensation, and termination of leases. Once the contractor can reasonably estimate its termination costs, a termination budget is submitted to CMS, which, in turn, reviews the termination budget and provides funding to the contractor.

For FYs 2010 through 2015, CMS contracted with BCBSA to serve as a Medicare contractor. BCBSA is a national federation of 36 independent, community-based, and locally operated Blue Cross and Blue Shield companies. BCBSA owns and manages the Blue Cross and Blue Shield trademarks and names in more than 170 countries and territories around the world. BCBSA grants licenses to independent companies to use the trademarks and names in exclusive geographic areas. BCBSA received \$25,798,907 in administrative costs for FYs 2010 through 2015, including \$436,795 in pension costs that were not reviewed. Pension costs will be the subject of a separate review.

## **HOW WE CONDUCTED THIS REVIEW**

We conducted our review by judgmentally sampling costs totaling \$1,625,238. In testing the sampled costs, we determined whether the costs were reasonable, allowable, and allocable and in compliance with the FAR and other applicable criteria. We limited our internal control review to those controls related to the recording and reporting of costs on the FACPs.

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

Appendix A contains the details of our audit scope and methodology.

## **FINDINGS**

The BCBSA FACPs for FYs 2010 through 2015 were presented fairly, and the program administration costs were generally reasonable, allowable, and allocable and in compliance with Federal regulations. However, we identified \$160,807 in unspent termination funds, a \$7,065 severance benefit overpayment, and \$5,945 in unallowable costs.

## **FEDERAL REGULATIONS**

The FAR requires contractors to be responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred and are allocable to the contract (§ 31.201-2(d)).

The FAR states that a cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of the 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, although a direct relationship to any particular cost objective cannot be shown (§ 31.201-4).

## **BLUE CROSS BLUE SHIELD ASSOCIATION DID NOT EXPEND ALL TERMINATION FUNDS RECEIVED**

At the end of FY 2015, BCBSA provided CMS with an estimate and budget for termination costs it expected to incur. CMS authorized \$963,342 in termination costs to BCBSA based on the estimate. At the time of our review, BCBSA provided a general ledger of expenditures totaling \$802,535.<sup>1</sup> The difference of \$160,807 represents unspent termination funds BCBSA received. Federal regulations state that accounting records should adequately demonstrate that costs have been incurred.

Termination costs were continuing to be incurred throughout this review. BCBSA officials informed us that since the general ledger date we reviewed, additional termination costs had been incurred, which will decrease the unspent termination funds, as noted above.

## **BLUE CROSS BLUE SHIELD ASSOCIATION OVERPAID SEVERANCE BENEFITS TO AN EMPLOYEE**

We determined that there was an overpayment of \$7,065 related to an employee's severance benefits. This overpayment occurred because BCBSA incorrectly reported an employee's paid time off benefit. Upon review of the employee's earnings statement, we determined that the actual expenditure paid to the employee was less than the budget estimate provided to CMS. Federal regulations state that contractors are responsible for accounting for costs appropriately. BCBSA did not make an adjustment to correct the overpayment even after the actual payment was incurred.

## **BLUE CROSS BLUE SHIELD ASSOCIATION CLAIMED SOME UNALLOWABLE COSTS**

BCBSA erroneously claimed \$5,945 in unallowable costs to the Medicare contract. BCBSA claimed costs for printing manuals totaling \$4,726. BCBSA had previously claimed this charge on its general ledger, making this a duplicate cost. The remaining \$1,219 consisted of two telephone invoices with misallocated sales taxes. Per Federal regulations, contractors are responsible for accounting for costs appropriately in addition to allocating incurred costs in a reasonable proportion to the benefits received. These costs were erroneously claimed and allocated for reimbursement.

## **RECOMMENDATIONS**

We recommend that BCBSA:

- refund \$160,807 to the Federal Government for unspent termination funds;
- work with CMS to determine the additional termination costs incurred after July 31, 2016, which will decrease the amount to be refunded; and

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<sup>1</sup> General ledger balance as of July 31, 2016.

- refund \$13,010 to the Federal Government for an overestimated severance benefit and unallowable costs.

### **BLUE CROSS BLUE SHIELD ASSOCIATION COMMENTS**

In written comments on our draft report, BCBSA concurred with our recommendations to refund \$160,807 in unspent termination funds, and \$13,010 for an overestimated severance benefit and unallowable costs.

BCBSA's comments are included in their entirety as Appendix B.

## APPENDIX A: AUDIT SCOPE AND METHODOLOGY

### SCOPE

Our review covered the period October 1, 2009, through September 30, 2015, for FACP costs, transition costs, and other related costs for terminating the contract, which were expensed in the next fiscal year. For this period, BCBSA received funds totaling \$25,798,907. This total included \$436,795 in postretirement benefits that are the subject of a separate review and, therefore, were excluded from this audit. Our audit scope covered \$25,362,112<sup>1</sup> in administrative costs.

We reviewed BCBSA's internal controls for allocating costs in accordance with the cost objectives specified in the FAR and the Medicare contract. We conducted this analysis to accomplish our objective and not to provide assurance on BCBSA's internal control structure.

We conducted fieldwork at BCBSA's office in Chicago, Illinois, from October 2015 through July 2016.

### METHODOLOGY

To accomplish our objectives, we:

- reviewed applicable Medicare laws, regulations, and guidelines and the applicable section of the FAR;
- reviewed BCBSA's contract with CMS;
- reviewed the independent auditor's reports for 2010 through 2015;
- reviewed BCBSA internal audit reports for 2010 through 2015;
- reconciled FACP line-item expenses on the cost classification report with the contractor's general ledger;
- reconciled transition costs as posted to the contractor's general ledger with the transition funds received from CMS;
- reconciled termination costs as posted to the contractor's general ledger with the termination funds received from CMS;
- judgmentally selected FACP costs totaling \$871,186 and reviewed supporting documentation;
- judgmentally selected transition costs totaling \$28,243 and reviewed supporting documentation;

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<sup>1</sup> These costs included FACP (\$24,289,242), transition (\$109,528), and termination (\$963,342) costs.



- judgmentally selected termination costs totaling \$725,809 and reviewed supporting documentation;
- interviewed BCBSA officials regarding the cost accumulation processes for cost proposal and cost allocation systems;
- reviewed established personnel and accounting policies and procedures to determine BCBSA's practices for allocating compensation costs to Medicare;
- reviewed payroll journals, corporate bonus plans, and personnel records;
- compared BCBSA's top five executives' compensation with benchmark compensation amounts published in the Federal Register and tested for excessive executive compensation claimed; and
- discussed our results with BCBSA officials.

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

## APPENDIX B: BLUE CROSS BLUE SHIELD ASSOCIATION COMMENTS



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January 20, 2017

Sheri L. Fulcher  
Regional Inspector General  
DHHS/OIG/Office of Audit Services, Region V  
233 North Michigan Avenue, Suite 1360  
Chicago, Illinois 60601

RE: Blue Cross and Blue Shield Association (BCBSA)  
Draft Audit Report Number: A-05-15-00056  
Review of Blue Cross Blue Shield Association Final Administrative Costs Proposals (FACPs)  
For Fiscal Year 2010 Through 2015

Dear Sheri:

Reference is to the draft audit report submitted to us under cover of your letter dated January 13, 2017.

Following are our comments on the Findings and Recommendations in the order in which they appear in the draft audit report:

- **Refund \$160,807 to the Federal Government for unspent termination funds - Page 3**  
BCBSA concurs to refund \$160,807 unspent termination funds to the Federal Government.
- **Work with CMS to determine the additional termination costs incurred after July 31, 2016, which will decrease the amount to be refunded - Page 3**  
BCBSA has determined that the additional termination costs incurred after July 31, 2016 were not significant and has forgone the additional termination costs.
- **Refund \$13,010 to the Federal Government for an overestimated severance benefit and unallowable costs - Page 4**  
BCBSA does not contest these findings and will refund \$13,010 to the Federal Government.

Blue Cross Blue Shield Association is an association of independent Blue Cross and Blue Shield companies.

Sheri L. Fulcher  
January 20, 2017  
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I want to thank you and your staff for the professional manner in which this audit was conducted and for affording us the opportunity to discuss the various issues raised during the on-site work. This spirit of cooperation clearly facilitated the timely completing of the audit.

Sincerely,

/Steve Mickelson/

Steve Mickelson  
Executive Director, Financial Services and Reporting

Copies: Terrance Cooney, BCBSA  
Mitchell Helfand, BCBSA  
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