



DEC 14 2000

REGION IV
Room 3T41
61 Forsyth Street, S.W.
Atlanta, Georgia 30303-8909

Ms. Ann Keown
Vice President Government Programs
Riverbend Government Benefits Administrator
Blue Cross Blue Shield of Tennessee
801 Pine Street
Chattanooga, Tennessee 37402

Dear Ms. Keown:

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) report entitled "Examination of the Administrative Costs Incurred Under the Health Insurance for the Aged and Disabled (Medicare) Part A". The audit covered the period October 1, 1995 through September 30, 1998. A copy of this report will be forwarded to the action official shown below for his review and any action deemed necessary.

The review was completed under a contract with the Department of Health and Human Services, OIG. The OIG exercised technical oversight and quality control of the examination. In our oversight, we found nothing to indicate that Carmichael, Brasher, Tuvell & Company's work was inappropriate or that the report cannot be relied upon.

Final determination as to actions taken on all matters reported will be made by 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 exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

To facilitate identification, please refer to Common Identification Number A-04-00-01207 in all correspondence relating to this report.

Sincerely yours,


for Charles J. Curtis
Regional Inspector General
For Audit Services

Enclosures - as stated

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Direct Reply to HHS Action Official:

Dale Kendrick
Associate Regional Administrator
for Medicare, Region IV

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REPORT OF EXAMINATION OF THE
ADMINISTRATIVE COSTS INCURRED
UNDER THE HEALTH INSURANCE FOR THE
AGED AND DISABLED (MEDICARE)**

PART A

**BLUE CROSS BLUE SHIELD OF TENNESSEE
CHATTANOOGA, TENNESSEE**

**FOR THE PERIOD
OCTOBER 1, 1995 THROUGH SEPTEMBER 30, 1998**



**JUNE GIBBS BROWN
Inspector General**

**DECEMBER 2000
A-04-00 -01207**

REPORT OF EXAMINATION OF THE
ADMINISTRATIVE COSTS INCURRED
UNDER THE HEALTH INSURANCE FOR THE AGED AND DISABLED (MEDICARE)

PART A

BLUE CROSS BLUE SHIELD OF TENNESSEE
CHATTANOOGA, TENNESSEE

FOR THE PERIOD
OCTOBER 1, 1995 THROUGH SEPTEMBER 30, 1998

NOTICE

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 Carmichael, Brasher, Tuvell & Company, Certified Public Accountants, as concurred with by the DHHS-OIG, Office of Audit Services. Final determinations on these matters will be made by authorized DHHS operating division officials.

EXECUTIVE SUMMARY

Backeround

The Health Care Financing Administration (HCFA) administers the Medicare Program by contracting with private organizations to process and pay claims for services provided to eligible beneficiaries. HCFA has contracted with Blue Cross Blue Shield of Tennessee (BCBS of TN) to process Part A claims submitted by certain hospitals and other medical suppliers in Tennessee. During the period October 1, 1995 through September 30, 1998, BCBS of TN claimed administrative costs of \$36,958,315 to process 13822,100 Part A claims.

Objectives

The objective of our audit was to determine whether (1) BCBS of TN had established effective systems of internal control, accounting and reporting for administrative costs and (2) the Final Administrative Cost Proposals (FACPs) presented fairly, in all **material** respects, the costs of program administration for the Part A program in accordance with Part 3 1 of the Federal Acquisition Regulations as interpreted and amended by Appendix B of BCBS of TN's agreement with HCFA.

Results

We determined that BCBS of TN had generally established adequate systems for internal control, accounting and reporting for administrative costs. Further, the administrative costs for the period October 1, 1995 through September 30, 1998, were generally in accordance with Part 3 1 of the Federal Acquisition Regulations as interpreted and amended by Appendix B of BCBS of TN's agreement with HCFA. However, we identified \$352,840 in charges reported on the FACP for which we recommend disallowance for the period October 1, 1995 through September 30, 1998. The items for which we recommend adjustments are as follows:

- BCBS of TN claimed \$34,412 in executive compensation during the fiscal period October 1, 1995 through September 30, 1998 which was in excess of the maximum limits allowed by Public Law 105-85.
- BCBS of TN did not comply with the requirements of FASB 43 with regards to the accrual of sick and vacation time. We did not recommend adjustments for this finding. However, we did recommend that BCBS of TN report paid time off based on actual accrued paid time off for all future periods.
- BCBS of TN charged administrative costs on fringe benefits at a rate of 16.5% for five months, August through December 1997. For all other period of the audit, BCBS of TN charged administrative costs on fringe benefits at a rate of 6.26% of claims paid. BCBS of TN should have charged an administrative rate of 10.6% for August through December 1997, the excess of which amounted to \$47,602 for fiscal year 1997 and \$71,403 for fiscal year 1998.
- BCBS of TN made adjustments to its books of account in preparing its FACPs for which adequate supporting documentation was not provided in the amounts of \$20,000 for fiscal year 1997 and \$146,809 for fiscal year 1998.

- BCBS of TN made adjustments to its books of account in preparing its FACP's to reclassify \$30,364 from professional and consulting costs to subcontracting costs in 1996. These cost were also reported in fiscal year 1997 as professional and consulting costs; hence the FACP for fiscal year 1997 was overstated by \$30,364.
- BCBS of TN did properly determine the ROI costs for the Memphis portion of its ROI costs. The Memphis portion of its ROI costs did not use an investment rate which included its bond portfolio. The ROI costs were overstated by \$1,363.
- BCBS of TN allocated \$887 in costs for items which were not allocable to the Medicare program.
- BCBS of TN failed to provide timely information throughout the course of our audit. Our audit fieldwork was extended substantially beyond the date intended due to the delay in receiving information.

We evaluated BCBS of TN's system of significant internal accounting **and administrative** controls, and compliance with laws and regulations that could materially **affect** the FACP's. Based on our evaluation, except as indicated above, BCBS of TN's control procedures were adequate for the Department of Health and Human Service's purposes and that BCBS of TN complied with the provisions of Part 3 1 of the Federal Acquisition Regulations as interpreted and amended by Appendix B of BCBS of TN's agreement with HCFA for the transactions tested. We have issued our report on compliance and the review of internal controls which appear on pages 4 and 6, respectively.

BLUE CROSS BLUE SHIELD OF TENNESSEE
Chattanooga, Tennessee
October 1, 1995 through September 30, 1998

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INTRODUCTION

Background

The Health Insurance for the Aged and Disabled (Medicare) program was established by Title XVIII of the Social Security Act. Hospital Insurance (Part A) provides protection against the cost of inpatient hospital care, post-hospital extended care, and post-hospital home health care. Supplemental Medical Insurance (Part B) is a voluntary program that covers physician services, hospital outpatient services, home health care and certain other health services. Part A and Part B provide insurance benefits to (1) eligible persons 65 and over, (2) disabled persons under 65 who have been entitled to Social Security benefits for at least 24 consecutive months and (3) individuals under age 65 with chronic kidney disease who are currently insured by or entitled to Social Security benefits.

The Health Care Financing Administration (HCFA) administers the Medicare Program by contracting with private organizations to process and pay claims for services provided to eligible beneficiaries. Contractors administering Part A of the program are known as Intermediaries and contractors administering Part B of the program are known as Carriers. The contracts between HCFA and the Intermediaries and Carriers define the functions which are to be performed and that costs allowable under the contract will be determined in accordance with Part 31 of the Federal Acquisition Regulations as interpreted and amended by the contract.

Objectives

The objectives of our audit were to determine whether (1) BCBS of TN had established an effective system of internal control, accounting and reporting for administrative costs incurred under the program and (2) the Final Administrative Cost Proposals (FACPs) presented fairly; in all material respects, the costs of program administration for Part A and B of the Medicare program in accordance with Part 31 of the Federal Acquisition Regulations (FAR) as interpreted and modified by Appendix B of BCBS of TN's contract with HCFA.

Scope

Our audit was conducted in accordance with generally accepted government auditing standards. The audit objective was to determine whether administrative costs claimed by BCBS of TN on its FACPs to administer Part A of the Medicare program for the period from October 1, 1995 through September 30, 1998 were reasonable, allocable and allowable. During the period October 1, 1995 through to September 30, 1998, BCBS of TN claimed administrative costs of \$36,958,315 to process 13,822,100 Part A claims.

We examined the administrative costs claimed by BCBS of TN to the extent we considered necessary to determine if amounts claimed were in accordance with Part 3.1 of the Federal Acquisition Regulations as interpreted and modified by Appendix B of BCBS of TN's contract with HCFA. Our audit included audit procedures designed to achieve our objective and included a review of accounting records and supporting documentation. Our audit excluded a review of the pension costs claimed by BCBS of TN on the FACPs. Pension costs were reviewed by the Office of Inspector General, Office of Audit Services and as such, were excluded from the scope of our audit.

We reviewed the action taken by BCBS of TN on prior audit findings and the effectiveness of BCBS of TN's corrective action in regard to the findings and recommendations. We reviewed and verified the accuracy of the cumulative "Interim Expenditure Reports" filed by BCBS of TN during the audit period. The tests performed were designed to determine if BCBS of TN prepared the reports based upon verifiable statistics which resulted in the accurate reporting of interim expenditures. We reviewed the methods and procedures utilized in the preparation of the April 2000 expenditure report to determine if the methods and procedures were adequately documented and would result in accurate reporting.

We reviewed BCBS of TN's compliance with complementary insurance policies and the amount of credit applied to BCBS of TN's claimed administrative costs for the periods from October 1, 1995 to September 30, 1998. Our procedures were designed to determine if BCBS of TN was complying with complementary insurance policies and that credits due Medicare were properly included in the FACPs.

We reviewed the extent to which BCBS of TN had incurred significant costs for planning, developing or modifying the Medicare claims processing system.

Audit fieldwork was performed at BCBS of TN's office in Chattanooga, Tennessee from October 25, 1999 through June 7, 2000.

**INDEPENDENT AUDITORS' REPORT ON
FINAL ADMINISTRATIVE COST PROPOSALS**

We have audited the administrative costs incurred and reported on the Final Administrative Cost Proposals of Blue Cross Blue Shield of Tennessee (BCBS of TN) for the period from October 1, 1995 through September 30, 1998. These Final Administrative Cost Proposals are the responsibility of BCBS of TN's management. Our responsibility is to express an opinion on the Final Administrative Cost Proposals based on our audit.

We conducted our audit in accordance with generally accepted auditing standards, Government Auditing Standards; 1994 Revision, and the Audit Guide for the Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers Under Title XVIII of the Social Security Act, dated February 25, 1991, issued by the Office of Inspector General - Department of Health and Human Services. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Final Administrative Cost Proposals are **free** of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts in the Final Administrative Cost Proposals. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the Final Administrative Cost Proposals. We believe that our audit provides a reasonable basis for our opinion.

BCBS of TN's policy is to prepare and report its costs of administering Part A of the Medicare program on the Final Administrative Cost Proposals in conformity with Part 31 of the Federal Acquisition Regulations as interpreted and modified by Appendix B of BCBS of TN's contract (Medicare Agreement) with the Health Care Financing Administration (HCFA) and HCFA's reporting procedures. Accordingly, the accompanying Final Administrative Cost Proposals are not intended to be a complete presentation of BCBS of TN's assets, liabilities, revenue and expenses.

We did not audit and do not express an opinion on the pension costs contained in the Final Administrative Cost Proposals for the period October 1, 1995 through September 30, 1998.

In our opinion, except for the above pension costs and the adjustments as disclosed in the findings and recommendations section of this report, the accompanying Final Administrative Cost Proposals, as adjusted, present fairly, in all material respects, the cost of administering Part A of the Medicare Program in accordance with Part 31 of the Federal Acquisition Regulations as interpreted and modified by Appendix B of BCBS of TN's Medicare Agreement and HCFA's reporting procedures.

This report is intended solely for the use described above and should not be used for any other purpose.

Carmichael, Brasher, Tuvell & Company

Atlanta, Georgia
June 7, 2000

INDEPENDENT AUDITORS' REPORT
ON COMPLIANCE WITH LAWS AND REGULATIONS

We have performed an audit of the Final Administrative Cost Proposals (FACPs) of Blue Cross Blue Shield of Tennessee (BCBS of TN) for the period October 1, 1995 through September 30, 1998 and have issued our report thereon, dated June 7, 2000.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, 1994 Revision, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the FACPs are **free** of material misstatement and whether BCBS of TN complied in all material respects with the provisions of Appendix B of the Medicare Agreement.

Compliance with laws, regulations and agreement requirements applicable to BCBS of TN is the responsibility of BCBS of TN management. As part of obtaining reasonable assurance about whether the FACPs were free of material misstatement, and whether BCBS of TN complied in all material respects with the provisions of Appendix B of the Medicare Agreement, we performed tests of compliance with certain provisions of laws, regulations and the agreement. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements or violations of prohibitions, contained in statutes, regulations or contracts, that cause us to conclude" that the aggregation of the misstatements resulting **from** those failures or violations are material to the Health Care Financing Administration (HCFA) agreement and the FACPs.

The results of our tests of compliance disclosed potential immaterial instances of noncompliance (see Schedule of Adjustments) with HCFA agreement provisions as disclosed in the Findings and Recommendations section of this report.

We considered the immaterial instances of noncompliance in forming our opinion on the FACPs and on BCBS of TN's compliance with HCFA agreement provisions, and this report does not affect our report on the FACPs dated June 7, 2000 and the opinion rendered therein.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, BCBS of TN complied, in all **material** respects, with the provisions referred to in the third paragraph of this report, and with respect to items not tested, nothing came to our attention that caused us to believe that BCBS of TN had not complied, in all material respects, with those provisions.

Nothing came to our attention in connection with our examination that caused us to believe that BCBS of TN was not in compliance with any of the terms and provisions of applicable agreements, laws, and regulations for those transactions not tested.

Nothing came to our attention in connection with our examination that caused us to believe that BCBS of TN was not in compliance with any of the terms and provisions of applicable agreements, laws, and regulations for those transactions not tested.

This report is intended solely for the use of management of BCBS of TN and the Department of Health and Human Services (DHHS). This restriction is not intended to limit the distribution of this report which, upon acceptance by the DHHS is a matter of public record.

Carmichael, Brasher, Jewell & Company

Atlanta, Georgia
June 7, 2000

INDEPENDENT AUDITORS' REPORT
ON INTERNAL CONTROL STRUCTURE

We have audited the Final Administrative Cost Proposals (FACPs) of Blue Cross Blue Shield of Tennessee (BCBS of TN) for the period October 1, 1995 to September 30, 1998 and have issued our report thereon, dated June 7, 2000.

We conducted our audit in accordance with generally accepted auditing standards and the standards for audits contained in the Government Auditing Standards, 1994 Revision, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the FACPs are free of material misstatement and whether BCBS of TN complied in all material respects with the provisions of Appendix B of the Medicare Agreement.

In planning and performing our audit of BCBS of TN, we considered its internal control structure and administrative controls as they relate to the Medicare Agreement in order to determine our auditing procedures for the purpose of expressing our opinion on the FACPs and whether BCBS of TN complied with Health Care Financing Administration (HCFA) agreement provisions and not to provide assurance on the internal control structure. Our study and evaluation was more limited than would be necessary to express an opinion on BCBS of TN's system of internal control structure taken as a whole.

The management of BCBS of TN is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures.

The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reports in accordance with HCFA agreement provisions. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purposes of this report, we have classified the significant internal control structure policies and procedures and administrative controls in the following categories:

Accounting Controls

- Cash receipts and disbursements
- Payroll and **fringe** benefits
- Indirect costs
- Depreciation and use charges
- Claims processing charges

Administrative Controls

- Interim Expenditure Reports (IER)
- Final Administrative Cost Proposal (FACP) Reports
- Subcontract and EDP Contracting
- Cost of Investment
- Complementary Insurance Credit
- Budget Comparisons

For all of the control categories listed above, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation. We also assessed control risk for the control categories listed above.

Our consideration of the internal control structure and administrative controls would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in **amounts** that would be material in relation to the HCFA agreement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted certain matters involving the internal control structure and its operations that we considered to be immaterial weaknesses as defined above (refer to the Findings and Recommendations section of this report).

This report is intended solely for the use of management and the Department of Health and Human Services (DHHS). This restriction is not intended to limit the distribution of this report which, upon acceptance by the DHHS, Office of Inspector General, is a matter of public record.

Carmichael, Brasheer, Jewell & Company

Atlanta, Georgia
June 7, 2000

**FINAL ADMINISTRATIVE COST PROPOSALS
(FACP'S)**

BLUE CROSS BLUE SHIELD OF TENNESSEE
 Final Administrative Cost Proposal
 For the Period October 1, 1995 through September 30, 1996
Part A

<u>Operation</u>	<u>FY96 Administrative Costs</u>
Bills Payment	\$ 4,129,192
Reconsiderations and Hearings	148,289
Medicare Secondary Payer	985,377
Medical Review & Utilization Review	1,000,181
Provider Desk Reviews	1,529,497
Provider Field Audits	574,755
Provider Settlements	667,313
Provider Reimbursement	8,167,899
Productivity Investments	74,217
Benefit Integrity	160,001
Other	230,528
Credits	<u>(210,960)</u>
TOTAL ADMINISTRATIVE COSTS CLAIMED	\$ <u>10,105,179</u>
Recommended Adjustments:	
Return on Investment	(478)
Unallocable Costs	<u>(81)</u>
Total Adjustments	\$ <u>(559)</u>
COSTS RECOMMENDED FOR ACCEPTANCE	\$ <u>10,104,620</u>

See Independent Auditors' Report.

Explanation of each adjustment is provided in the Findings and Recommendations section of this report.

BLUE CROSS BLUE SHIELD OF TENNESSEE
 Final Administrative Cost Proposal
 For the Period October 1, 1996 through September 30, 1997
Part A

<u>Operation</u>	<u>FY97 Administrative Costs</u>
Bills Payment	\$ 5,115,918
Reconsiderations and Hearings	234,027
Medicare Secondary Payer	1,077,859
Medical Review & Utilization Review	960,137
Provider Desk Reviews	1,915,889
Provider Field Audits	353,890
Provider Settlements	654,722
Provider Reimbursement	1,057,701
Productivity Investments	329,211
Benefit Integrity	171,624
Other	0
Credits	<u>(213,696)</u>
TOTAL ADMINISTRATIVE COSTS CLAIMED	\$ <u>11,657,282</u>
Recommended Adjustments:	
Executive Compensation	\$ (19,089)
Fringe Benefits	(47,602)
Unsupported Costs	(20,000)
Misreported Costs	(30,364)
Return on Investment	<u>(401)</u>
Total Adjustments	\$ <u>(117,456)</u>
COSTS RECOMMENDED FOR ACCEPTANCE	\$ <u>11,539,826</u>

See Independent Auditors' Report.
 Explanation of each adjustment is provided in the Findings and Recommendations
 section of this report.

BLUE CROSS BLUE SHIELD OF TENNESSEE
Final Administrative Cost Proposal
For the Period October 1, 1997 through September 30, 1998
Part A

<u>Operation</u>	<u>FY98 Administrative Costs</u>
Bills Payment	\$ 4,783,758
Reconsiderations and Hearings	496,521
Inquiries	1,001,955
Provider Education and Training	141,303
Medicare Secondary Payer	1,009,799
Medical Review & Utilization Review	1,239,503
Provider Desk Reviews	135,513
Provider Field Audits	65,691
Provider Settlements	122,646
Provider Reimbursement	23,105
Productivity Investments	408,198
Benefit Integrity	170,022
PM Special Projects	2,410
Credits	<u>(209,701)</u>
TOTAL ADMINISTRATIVE COSTS CLAIMED	\$ <u>9,390,723</u>
Recommended Adjustments:	
Executive Compensation	\$ (15,323)
Fringe Benefits	(71,403)
Unsupported Costs	(146,809)
Return on Investment	(484)
Unallocable Costs	<u>(806)</u>
Total Adjustments	\$ <u>(234,825)</u>
COSTS RECOMMENDED FOR ACCEPTANCE	\$ <u>9,155,898</u>

See Independent Auditors' Report.
Explanation of each adjustment is provided in the Findings and Recommendations
section of this report.

FINDINGS AND RECOM MENDATIONS

BLUE CROSS BLUE SHIELD OF TENNESSEE
Findings and Recommendations
For the Period October 1, 1995 through September 30, 1998

Executive Compensation

Section 808 of Public Law 105-85 limited, for fiscal years 1997 and tier, the amount of executive compensation which can be allocated to Medicare. The limitation is for the top five company employees and top five employees within the Medicare division. Salaries of these individuals, defined as total taxable wages plus elective deferrals before any allocations are applied, was limited to \$250,000 for 1997 and \$340,650 for 1998.

In fiscal years 1997 and 1998, one executive's compensation exceeded the allocable amounts in accordance with P.L. 105-85 as follows:

	<u>1997</u>	<u>1998</u>
Actual Salary	\$583,725	\$589,398
Allowable Salary per P.L. 105-85	<u>250,000</u>	<u>340,650</u>
Excess Compensation per P.L. 105-85	333,725	248,748
% of Cost Center Allocated to Medicare	<u>5.72%</u>	<u>6.16%</u>
Excess Compensation	<u>\$ 19,089</u>	<u>\$ 15,323</u>

Recommendation

We recommend that BCBS of TN exclude \$19,089 from its 1997 fiscal year FACP and exclude \$15,323 from its 1998 fiscal year FACP for excess executive compensation.

Auditee's Response

BCBS of TN agreed with our finding. BCBS of TN indicated that they had filed an amended FACP to exclude the \$15,323 from salary costs subsequent to the audit fieldwork.

Auditor's Conclusion

BCBS of TN should exclude \$19,089 from its 1997 fiscal year FACP for excess compensation. BCBS of TN has indicated that an amended FACP has been filed to exclude \$ 15,323 from the 1998 fiscal year FACP.

Salary Accrual for Paid Time Off

BCBS of TN does not have policies and procedures in place to ensure that salaries and wages are consistently adjusted for paid time off accrued by employees. BCBS of TN did not begin accruing paid time off until January 1999, after the end of our audit period. BCBS of TN charged for paid time off as incurred through December 1998. The amount of salaries, overstated or understated due to BCBS of TN not accruing paid time off could not be determined. FASB 43 requires that paid time off be accrued when identifiable and measurable.

BLUE CROSS BLUE SHIELD OF TENNESSEE

Findings and Recommendations

For the Period October 1, 1995 through September 30, 1998

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Recommendation

BCBS of TN should demonstrate that salary costs were not overstated due to their failure to comply with FASB 43. Future auditors are alerted to the potential overstatement of costs at such time as BCBS of TN accrues for paid time off and allocates these charges to Federal programs.

Auditee's Response

BCBS of TN agreed with our finding.

Auditor's Conclusion

No further comments.

Fringe Benefits

BCBS of TN allocated fringe benefit costs to each of its internal departments based on actual claims paid less actual premiums collected from employees plus an administrative charge. For calendar year 1996, January through July 1997 and calendar year 1998, BCBS of TN determined the administrative charge based on a rate of 6.26% which was determined by BCBS of TN to be representative of actual costs of administering the benefits. However, for August through December 1997, BCBS of TN computed the administrative charge based on a rate of 16.5%. BCBS of TN should have charged an administrative rate of 10.6% for August through December 1997. BCBS of TN explained that the return to a 6.26% administrative charge was made in 1998 because it was a more correct way of computing costs. The incremental administrative charges for August and September, or fiscal year 1997 totaled \$47,602 and for October through December 1997, or fiscal year 1998, totaled \$71,403.

Recommendation

BCBS of TN should provide justification that administrative charges of 16.5% represent the actual costs to administer the fringe benefits or adjust its FACP for fiscal year 1997 by \$47,602 and for fiscal year 1998 by \$71,403.

Auditee's Response

BCBS of TN agreed with our finding.

Auditor's Conclusion

BCBS of TN should exclude \$47,602 from its 1997 fiscal year FACP and \$71,403 from its 1998 fiscal year FACP for fringe benefits.

BLUE CROSS BLUE SHIELD OF TENNESSEE
Findings and Recommendations
For the Period October 1, 1995 through September 30, 1998

Unsupported Costs

BCBS of TN made adjusting entries to its records which resulted in increased or adjusted costs on its FACPS. Adequate supporting documentation to justify the amounts added or reclassified from the books of account to the FACPs was not provided. The following adjustments were made for which adequate supporting documentation was not provided.

<u>Fiscal Year</u>	<u>Amount</u>	<u>Nature of Adjustment</u>
1997	\$ 20,000	Adjustment to increase travel costs
1998	\$ 52,403	Reclassification from other expense to subcontract expense
1998	\$ 34,375	Adjustment to increase subcontract costs
1998	\$ 60,031	Adjustment to increase subcontract costs

The draft audit report also questioned an adjustment made to the FACP in the amount of \$165,439. BCBS of TN provide adequate documentation to support this adjustment in their response to the draft audit report. The adjustment was made incorrectly and should have resulted in an additional \$28,278 in charges to Medicare for subcontracting costs for fiscal year 1996. BCBS of TN may choose to amend the 1996 fiscal year FACP to include the additional \$28,278 in subcontracting costs.

Recommendation

We recommend BCBS of TN provide support to justify the adjustment made to increase costs claimed on its FACPS by \$20,000 for fiscal year 1997 and \$146,809 for fiscal year 1998 or exclude these costs from their FACPs.

Auditee's Response

BCBS of TN agreed with our finding.

Auditor's Conclusion

BCBS of TN should exclude \$20,000 from its 1997 fiscal year FACP and \$146,809 from its 1998 fiscal year 1998 FACP for unsupported costs.

BLUE CROSS BLUE SHIELD OF TENNESSEE
Findings and Recommendations
For the Period October 1, 1995 through September 30, 1998

Misreported Costs

In preparation of the 1996 fiscal year FACP, BCBS of TN made an adjustment to its FACP which was intended to reclassify costs of \$30,364 from professional and consulting costs to subcontract costs. However, the costs were added to subcontract costs, but not excluded from professional and consulting costs. Consequently, BCBS of TN's 1996 fiscal year FACP was overstated by \$30,364.

Recommendation

BCBS of TN should exclude \$30,364 from its 1996 fiscal year FACP.

Auditee's Response

BCBS of TN agreed with our finding.

Auditor's Conclusion

BCBS of TN should exclude \$30,364 from its 1996 fiscal year FACP for misreported costs.

Return on Investment

BCBS of TN claimed return on investment costs of \$15,820, \$9,723 and \$3,622 for fiscal years 1996, 1997 and 1998, respectively on its FACP for ROI costs associated with its Memphis operations. BCBS of TN's calculation of ROI used its portfolio rate of return on only its stock investment portfolio, excluding its bond investment portfolio. The ROI for the Memphis portion of BCBS of TN's Medicare operations should be as follows:

	<u>1996</u>	<u>1997</u>	<u>1998</u>
Average Undepreciated Balance of Assets	\$4,202,163	\$4,483,844	\$4,483,844
Correct Portfolio Rate of Return	<u>5.46%</u>	<u>6.27%</u>	<u>6.18%</u>
Allowable ROI for Memphis Operations	\$ 229,438	\$ 281,137	\$ 277,102
Percentage Allocable to Medicare	<u>6.69%</u>	<u>3.32%</u>	<u>1.13%</u>
Correct ROI for Memphis Operations	\$ 15,342	\$ 9,322	\$ 3,138
ROI claimed for Memphis Operations	<u>\$ 15,820</u>	<u>\$ 9,723</u>	<u>\$ 3,622</u>
Costs to Exclude from FACP	<u>\$ 478</u>	<u>\$ 401</u>	<u>\$ 484</u>

Recommendation

We recommend that BCBS of TN exclude \$478 from its 1996 fiscal year FACP, \$401 from its 1997 fiscal year FACP and \$484 from its 1998 fiscal year FACP.

BLUE CROSS BLUE SHIELD OF TENNESSEE
Findings and Recommendations
For the Period October 1, 1995 through September 30, 1998

Auditee's Response

BCBS of TN agreed with our finding.

Auditor's Conclusion

BCBS of TN should exclude **\$478** from its 1996 fiscal year FACP, \$401 from its 1997 fiscal year FACP and \$484 from its 1998 fiscal year FACP for costs associated with ROI.

Unallocable Costs

BCBS of TN allocated \$887 in costs to Medicare which were for unallowable or **unallocable** items. Costs of \$776 were allocated to Medicare for the printing of a subscriber newsletter where the benefit to Medicare was evident. Costs of \$111 were allocated to Medicare for unallowable activities.

Recommendation

We recommend BCBS of TN exclude \$81 from the 1996 fiscal year FACP and \$806 from the 1998 fiscal year FACP for costs not allocable to Medicare.

Auditee's Response

BCBS of TN agreed with our finding.

Auditor's Conclusion

BCBS of TN should exclude \$81 from the 1996 fiscal year FACP and \$806 from the 1998 fiscal year FACP for costs not allocable to Medicare.

Audit Cooperation

Our audit of BCBS of TN was scheduled to be conducted from October 25, 1999 through December 15, 1999. Our fieldwork concluded on June 7, 2000. Our audit fieldwork took considerably longer than planned due partly to the lack of timely documentation provided by BCBS of TN. BCBS of TN often did not provide documentation when it was requested and when information was finally provided, the information was not complete or would be an example of information requested with details to come later, necessitating further requests for information.

BLUE CROSS BLUE SHIELD OF TENNESSEE
Findings and Recommendations
For the Period October 1, 1995 through September 30, 1998

One example of information not timely provided which significantly increased the duration of our audit was the information we requested to support the adjustments made from BCBS of TN's books of account to the FACPs. We requested, in writing, the information to support these adjustments on October 26, 1999; November 11, 1999; January 4, 2000; January 12, 2000; January 20, 2000; February 9, 2000 and April 27, 2000. On April 27, 2000, we issued an Items Noted During Review to BCBS of TN stipulating that if the information requested was not received by the end of that day; all associated costs would be questioned. The information was provided on April 27, 2000. Prior to obtaining this information, we were unaware that BCBS of TN made adjustments to their books of account for costs incurred by its Memphis segment which were not included in the costs we had already audited. Upon receiving this information, we then had to request the information and test salaries, fringe benefits, electronic data processing, return on investment and miscellaneous costs for the Memphis segment.

Another example of information not timely provided which significantly increased the duration of our audit was the information we requested to support fringe benefits. We requested, in writing, the information to support fringe benefits on October 26, 1999; November 11, 1999; January 4, 2000; January 19, 2000. On January 19, we received the Balance Sheets and Income Statements we had requested, but information with regards to how premium income was derived and the claims expense detail was not provided. This information was requested on January 20, 2000; February 9, 2000 and April 27, 2000. On April 27, 2000, we issued an Items Noted During Review to BCBS of TN stipulating that if the information requested was not received by the end of that day; all associated costs would be questioned.

Some information, though not as requested, was provided on April 27, 2000, but the information was still not sufficient for audit purposes. Sufficient information for us to audit fringe benefit costs was provided on May 23, 2000.

BCBS of TN's lack of providing timely documentation significantly increased the time incurred to perform and the duration of our audit. We continually informed BCBS of TN as to the items which were outstanding both orally and in writing. The personnel to whom BCBS of TN had designated as our contacts did not appear to have the time available to efficiently coordinate our audit.

A further impediment to a timely audit was that the audit covered a three year fiscal period, reaching back to records which were archived and during which BCBS of TN changed accounting systems and key personnel in the Medicare area. The delays in BCBS of TN responding to audit requests are also partially attributable to the time period in which the audit was started which was during the fiscal year-end period when the FACPs are normally prepared.

BLUE CROSS BLUE SHIELD OF TENNESSEE
Findings and Recommendations
For the Period October 1, 1995 through September 30, 1998

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Auditee's Response

BCBS of TN responded that they have established a new position to oversee Medicare, FEP and cost allocations. BCBS of TN also addressed the timing of the audit which conflicted with the Company's year-end closing and that the audit encompassed a third year period. BCBS of TN also merged with the Memphis plan, bid and began transition of the New Jersey Medicare Part A workload and was dealing with Y2k issues during the course of the audit.

Auditor's Conclusion

BCBS of TN's implementation of a new position to oversee Medicare, FEP and cost allocations did appear, in the last portion of our audit, to aide in obtaining documents. This position may aide in the coordination of future audits. The timing of the audit is a by-product of the time requirements imposed by the contracts under which this audit was awarded and additional time or longer performance requirements would be necessary to change the timing of the audit fieldwork. The employees with whom we dealt with during the course of the audit were involved in numerous other events which did appear to impact on the time they were able to commit to obtaining documentation for audit.

BLUE CROSS BLUE SHIELD OF TENNESSEE

OTHER MATTERS

For the Period October 1, 1995 through September 30, 1998

Complementary Insurance Financial Policies

Our review of BCBS of TN's complementary insurance financial policies, as discussed in the "Scope of Audit" section of this report, disclosed that BCBS of TN received approval for its complementary insurance claims processing operations, as required by program regulations. The complementary claims operation was approved by HCFA in June, 1998. It appears that BCBS of TN is calculating and crediting Medicare in accordance with the approved cost rate.

Plan's Interim Expenditure Reports

We reviewed BCBS of TN's method for preparing its Interim Expenditure Reports (**IERs**). BCBS of TN's April 2000 "Cumulative Interim Expenditure Report" agreed to the internal accounting documents maintained to support the IER. No matters came to our attention during our review which would indicate that BCBS of TN's methods and procedures for the preparation of the Interim Expenditure Reports were not adequate.

Significant EDP Expenditures

No significant EDP costs were incurred during our audit period for planning, development or modification of the Medicare claims processing system for Part A or B of the Medicare program other than **funds** expended to correct problems associated with Y2K.

**AUDITEE'S RESPONSE
TO
DRAFT AUDIT REPORT**



October 25, 2000

Diana Crawford, CPA
Carmichael, Brasher, Tuvell & Company
Certified Public Accounts
Dunwoody Exchange
1647 Mount Vernon Road
Atlanta, Georgia 30338

RE: Draft Audit **Report for fiscal years 1996, 1997, & 1998**

Dear Ms. Crawford,

We have reviewed the draft audit **report for BlueCross BlueShield** of TN prepared by your firm dated September 27, 2000. **This** audit report covered administrative costs for the Medicare period covering October 1, 1995 through September 30, 1998. This letter is our response to your findings.

We were pleased to **read that you determined that** we had generally established adequate systems for **internal control, accounting and** reporting and that administrative costs for the period audited were generally **in** accordance with Part 31 of the Federal Acquisition **Regulations as interpreted by Appendix B of BCBS of TN's** agreement with HCFA

We reviewed **the** seven items **amounting to \$518,279 recommended for disallowance, as** summarized on **Exhibit 1** attached. **We** concur with all **recommended** adjustments except for one. Our **calculation of adjustments** owed the Medicare program amount to \$309,239. The difference of \$209,040 is for item **#4, FY96** involving **payments** to a third party vendor for claim processing transactions and supporting activities provided.

Exhibit 2 (attached) provides a **summary of** the amount claimed **on the FY96 FACP \$880,746** including a manual adjustment of \$107,813. It also contains details of general ledger entries and manual adjustments/explanations for the difference between the general ledger and the FACP. Our analysis resulted **in** an undercharge of \$28,278 instead of the \$165,439 overcharge in your recommendation. Copies of each invoice paid for the **FY96** period are attached, as well as, invoices containing credits for the FY95. These credits and special billing invoices were the primary contributing factors resulting in **an** understatement **in** the **FY96** general ledger and consequently requiring a manual adjustment to report the total cost for this expense on the FY96 FACP.

Your report also noted that our plan had not provided timely information throughout the **course** of the audit. Our plan is addressing some of those issues, those within our control- We will also comment on issues outside of our **control**, which made this audit difficult. **Our plan has** established a new position "Coordinator of Government Reporting and Cost Allocations" to oversee **Medicare**, FEP and cost allocations. The position is responsible for investigating and implementing best practices that support internal control, accounting and reporting to ensure compliance **with** our governmental contracts. Objectives for the position include **providing** policies and procedures that support administrative costs claimed for governmental contracts.

This position **was** filled in February 2000 by Annette White who has already begun to make improvements. Unfortunately, we were well into this audit before she accepted this position. With respect to issues outside of our control, several items are worth mentioning. First, the audit period was conducted during **BCBST's** year-end closing, a difficult time when we prepare **both** GAAP and Statutory financial statements, as well as, setting up **financials** for the new year. Our preference for an audit would be the second quarter. Second, these audits cover three years and the audits usually begin a couple of years after the fiscal period being audited. A move to one-year or **two-year** audits would lessen some of the difficulties due to **time** span alone. Third, a couple of events contributed to making this audit more difficult than others. Our plan merged with the Memphis **plan** for the periods audited, our plan bid and began transition of the New Jersey Medicare Part **A** workload during the **audit** and Y2K reporting adjustments to **FY98** caused considerable reporting complexities (forward funding, additional IER each month, funding spanning three budget years). In summary, we are tackling the **issues** within our control and ask that you and the appropriate government agencies consider our feedback on the other issues.

If you have questions regarding any of my comments or exhibits, **please** contact me.

Sincerely,



Steven E. Kerr
Steve_Kerr@bcbst.com
(423)752-8207

EXHIBIT 1

MEDICARE AUDIT - DOLLAR AMOUNTS INVOLVED IN REVISED DRAFT OF FINDINGS FOR 96197198 ADMINISTRATIVE COSTS				
Item #	FY	BCBST Amount	Auditor Amount	Remarks
1				
	Executive Compensation			
	97	\$19,089	\$19,089	Agree with Finding
	98	\$15,322	\$15,322	Agree with Finding
2	Paid Time Off	-	-	
3	Administrative Cost - Health Insurance			
	97	\$47,602	\$47,602	Agree with Finding
	98	\$7 1,403	\$71,403	Agree with Finding
4	Subcontracting			
	96	(\$28,278)	\$165,439	Exhibits attached
	97	\$20,000	\$20,000	Agree with Finding
	98	\$52,403	\$52,403	Agree with Finding
	98	\$34,375	\$34,375	Agree with Finding
	98	\$60,031	\$60,031	Agree with Finding
5	Consulting Cost			
	96	\$14,911	\$14,911	Agree with Finding
	97	\$15,453	\$15,453	Agree with Finding
6	Memphis ROI			
		\$1,363	\$1,363	Agree with Finding
7	Unallowable Cost			
	96	\$81	\$81	Agree with Finding
	98	\$806	\$806	Agree with Finding
		<u>\$324,561</u>	<u>\$518,278</u>	
		<u>(\$15,322)</u>		Adjustment already made on FY98 FACP 5/13/2000
		<u>\$309,239</u>	<u>\$518,278</u>	