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 AND BLUE SHIELD OF NEW JERSEY NEWARK, NEW JERSEY

FOR THE PERIOD OCTOBER 1, 1994 THROUGH SEPTEMBER 30, 1997

SEPTEMBER 2001
A-02-00-01019

Office of Inspector General

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Office Of Inspector General
Office Of Audit Services

DEPARTMENT OF HEALTH & HUMAN SERVICES

Region II
Jacob K. Javits Federal Building
26 Federal Plaza
New York, NY 10278

September 27, 2001

Our Reference: Common Identification Number A-02-00-01019

Ms. Pamela T. Miller
Vice President, Enterprise Strategy and Quality
Horizon Blue Cross Blue Shield of New Jersey
3 Penn Plaza East
Newark, NJ 07105

Dear Ms. Miller:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), Office of Audit Services' (OAS) final audit report entitled "**REPORT OF EXAMINATION OF THE ADMINISTRATIVE COSTS INCURRED UNDER THE HEALTH INSURANCE FOR THE AGED AND DISABLED (MEDICARE), PART A, BLUE CROSS AND BLUE SHIELD OF NEW JERSEY, NEWARK, NEW JERSEY, FOR THE PERIOD OCTOBER 1, 1994 THROUGH SEPTEMBER 30, 1997.**" A copy of this report will be forwarded to the action official noted below for review and any action deemed necessary.

The audit was performed by the Certified Public Accounting firm of Leon Snead & Company, P.C. under a contract with the OIG. The OIG exercised technical oversight and quality control of the examination. In our oversight, we found nothing to indicate that Leon Snead & Company, P.C.'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 CMS action official named below. We request that you respond to the 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, 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 45 CFR Part 5.)

To facilitate identification, please refer to Common Identification Number A-02-00-01019 on all correspondence relating to this report.

Sincerely yours,

Timothy J. Horgan
Regional Inspector General
For Audit Services

Enclosures

Direct Reply to CMS Action Official:

Peter Reisman
Associate Regional Administrator for Medicare
Centers for Medicare and Medicaid Services, Region II
Jacob K. Javits Federal Building
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New York, NY 10278

Audit of Administrative Costs
Medicare Part A

Horizon Blue Cross and Blue Shield
of
New Jersey

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 Leon Snead & Company, P.C., Certified Public Accountants & Management Consultants, 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.

Submitted By

Leon Snead & Company, P.C.
Certified Public Accountants & Management Consultants

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Independent Auditor's Report

Ms. Pamela T. Miller
Vice President, Enterprise Strategy and Quality
Horizon Blue Cross Blue Shield of New Jersey
3 Penn Plaza East
Newark, NJ 07105

Dear Ms. Miller:

This report provides the results of our audit of administrative costs claimed by Blue Cross and Blue Shield of New Jersey (BCBSNJ) for Medicare Part A during the period October 1, 1994 through September 30, 1997. The objectives of our audit were to (1) ascertain whether BCBSNJ's final administrative cost proposals presented fairly the costs of program administration, (2) determine if the administrative costs claimed by BCBSNJ are reasonable, allocable, and allowable in accordance with Part 31 of the Federal Acquisition Regulation, the Intermediary Manual and the Medicare contract and, (3) determine if BCBSNJ had effective systems of internal control, accounting, and reporting for administrative costs incurred under the program. Our audit was performed under contract with the Department of Health and Human Services (DHHS), Office of Inspector General (OIG). The report does not include comments from BCBSNJ officials. BCBSNJ was given 30 days to provide comments to the draft report, but they did not. The comments period was extended by 30 days on June 26, 2001 but again no comments were provided.

Our audit was performed in accordance with generally accepted government auditing standards and the Audit Guide for the Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers Under Title XVIII of the Social Security Act, developed by the DHHS, OIG.

During the period BCBSNJ submitted Final Administrative Cost Proposals (FACP) claiming costs of $24,520,134. We are questioning costs of $135,124. The Results of Audit section contains details on the costs questioned. Appendixes A through C contain schedules of the costs claimed on the FACPs, costs accepted, and costs questioned for each of the 3 years audited.

BACKGROUND

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled Program (Medicare). Medicare provides a hospital and related medical insurance program for eligible persons age 65 and over. Coverage is available to disabled persons under age 65 who have been entitled to Social Security or Railroad Retirement disability benefits for at least 24 consecutive months and to individuals under age 65 with chronic kidney disease who are currently insured by or entitled to Social Security benefits. Medicare, Part A, provides protection against the costs of hospital inpatient care, post-hospital extended care, and post hospitalization home health care. Part B provides protection against the costs of physician services, laboratory testing, diagnostic testing, ambulance services, durable medical equipment, and other related services. The DHHS, has overall responsibility for the administration of Medicare. The Health Care Financing Administration, a component of DHHS, has primary responsibility for Medicare.

Title XVIII provides that public or private organizations, known as intermediaries for Part A and carriers for Part B, may assist in the administration of the Medicare program. Intermediaries and carriers are organizations, primarily Blue Cross plans and commercial insurance companies, that have been nominated by provider groups or associations to process claims and make payments that are due under the Medicare program. The Secretary of the DHHS enters into agreements with the Blue Cross and Blue Shield Association and commercial insurance companies that participate as intermediaries or as carriers for Medicare. The Blue Cross Blue Shield Association, with the approval of the Secretary of DHHS, subcontracts with member Blue Cross plans to perform the intermediary and carrier function in designated areas.

The contracts define the functions to be performed and provide for the reimbursement of allowable administrative cost incurred while performing them. Medicare contractors submit prospective budgets of administrative costs to the Health Care Financing Administration for review and approval. Interim expenditure reports are submitted monthly comparing accrued expenditures to approved budget amounts. Following the close of each fiscal year the contractor submits a Final Administrative Cost Proposal reporting the administrative costs of performing Medicare functions during the year.

BCBSNJ had a subcontract agreement with the Blue Cross Blue Shield Association to serve as a Part A intermediary during the period October 1, 1994 through September 30, 1997. During that period BCBSNJ processed 7,677,794 claims valued at approximately $8.8 billion, submitted by health care providers consisting of hospitals, home health agencies, skilled nursing facilities and other providers such as hospices and mental health facilities.

SCOPE

During the audit planning process we evaluated the adequacy of BCBSNJ's internal controls procedures. Our evaluation included a review of BCBSNJ's procedures for approving and recording expenditures, the method used in allocating expenditures to the Medicare program and the procedure for assigning cost to applicable expense categories.

We followed up on 19 findings and recommendations contained in a prior audit report, issued by the OIG on BCBSNJ administrative costs for FY1990 through FY1994. Eighteen of the recommendations related to financial adjustments and one related to procedural changes. The recommendations and the results of our follow-up is provided in Appendix D.

We selected 14 cost categories for testing of transactions from BCBSNJ's records to review supporting documentation. The categories selected were executive compensation, external computer terminal credits, print-promotional, moving cost, investigations control, travel, salaries, information systems-man hours, information systems-equipment, consulting charges, outside agency fees, print-general, employee health insurance, and complementary insurance credits. The first 10 categories were selected because of findings in the prior audit report and the remainder because they are major expense items claimed on the Final Administrative Cost Proposals.

In addition, we reconciled the costs claimed on the final administrative cost proposals to the accounting system. The reconciliation did not disclose any significant discrepancies. In accordance with guidance provided by the DHHS, OIG, our review did not address pension segmentation costs.

Our audit work was performed from February through October 6, 2000 at BCBSNJ's offices in Newark, New Jersey and through mail and other communications between Leon Snead & Company, P.C. and BCBSNJ officials. BCBSNJ was given 30 days to provide comments to the draft of this report, but they did not. The comments period was extended by 30 days on June 26, 2001 but again no comments were received.

RESULTS OF AUDIT

The BCBSNJ claimed administrative costs totaling $24,520,134 during the 3-year period in our review. We are questioning costs of $135,124. The questioned costs consist of $16,829 for payment of executive salary increases that exceeded Employment Cost Index indices developed by the Department of Labor and for costs totaling $118,295 associated with external computer terminals. Both cost categories were addressed in a prior audit report. The costs for the remaining categories tested were reasonable, allocated properly and allowable in accordance with the FAR, the Intermediary Manual and the Medicare contract.

Executive Compensation

Our review of salary increases for executives whose salaries were allocated to Medicare during FY95 through FY97 showed that the average annual salary increase was 14.6 per cent. The average salary increase for that period using Employment Cost Index indices developed by the Department of Labor would have been 4.03 per cent. Similar conditions were reported during the audit of BCBSNJ's administrative costs for FY90 through FY94.

The prior audit report concluded that annual salary increases to BCNBSNJ executives were excessive resulting in increased cost to the Medicare program. The auditor used Employment Cost Index indices to determine that BCBSNJ annual executive salary increases averaged 12.5 percent higher then their peers in other organizations. The report questioned executive salary costs of $290,400 charged to Medicare.

Section 31.201-2(a) of the Federal Acquisition Regulation (FAR) states that one of the factors to be considered in determining whether a cost is allowable, is whether the cost is reasonable. In addition, Section 31.205-6(b) of the FAR states that:

"Based on an initial review of the facts, contracting officers or their representatives may challenge the reasonableness of any individual element or the sum of the individual elements of compensation paid or accrued to particular employees or classes of employees. In such cases, there is no presumption of reasonableness and upon challenge, the contractor must demonstrate the reasonableness of the compensation item in question."

For this assignment we computed annual salaries using actual and ECI adjusted salaries developed during the prior audit. Using FY94 actual and adjusted salaries we used ECI indices and salary increase rates provided by BCBSNJ to develop ECI adjusted and actual salary levels for FY95 through FY97.

Executive salaries and associated fringe benefits were allocated to Medicare from three cost centers. We computed the amount of excessive salary paid by calculating the ratio of costs allocated to Medicare to total cost center costs and applied it to the difference between actual salary and ECI adjusted salaries. Our analysis showed that Medicare was allocated excessive executive salary costs of $16,829.

Recommendation

We recommend that BCBSNJ reduce their claim for administrative costs by $16,829.

External Computer Terminals

The prior audit report contained a finding on external computer terminals used by providers to submit Medicare claims. BCBSNJ provides the terminals to Medicare providers for a monthly fee. The prior audit report indicated that Medicare had been allocated costs associated with the external terminals but none of the fee revenue. The report questioned costs of $102,045 and recommended BCBSNJ improve their accounting for and reporting of external terminal costs and revenue. In their comments to the report, BCBSNJ disputed the finding and the amount of questioned costs. The finding has not been resolved.

During our follow up on this issue we were unable to determine if external terminal costs or revenue was allocated to Medicare. BCBSNJ officials stated that the costs associated with the terminals were not allocated to Medicare, and accordingly, none of the revenue would be credited either. They stated that documentation would be provided to support that position. However, after many requests, documentation has not been provided.

During the period FY95 through FY97 approximately $2.2 million was allocated to Medicare for information system users charges and approximately $657,194 for information systems equipment. According to computer inventory records from the prior audit, 673 or 18% of the terminals were external. We are questioning costs of $118,295 or 18% of total information systems equipment costs because the finding in the prior report has not been resolved for this same issue and documentation supporting BCBSNJ's current assertions regarding costs and revenues were not provided.

Recommendation

We recommend that BCBSNJ reduce their claim for administrative costs by $118,295.

Conclusion

Except for the executive salaries and external terminals addressed above, the final administrative cost proposals, presented fairly the costs of program administration applicable to Medicare part A for the period beginning October 1, 1994 through September 30, 1997. Our testing showed that claimed costs were allowable, allocable, and reasonable in accordance with the Federal Acquisition Regulation, Part 31, the Intermediary Manual, and the Medicare contract. Further, nothing came to our attention to cause us to believe that untested items were not in compliance with applicable laws and regulations.

BCBSNJ had established effective systems of internal, accounting and reporting controls to properly identify, and report administrative costs applicable to the Medicare program. Therefore, we are accepting $24,385,010 of claimed administrative costs as reasonable and allowable.

OTHER MATTERS

In accordance with Health Care Financing Administration guidance, we reviewed the most recent interim expenditure report submitted by BCBSNJ for accuracy. Our review of the methodology used to develop the January 2000 expenditure report and limited testing did not disclose any inaccuracies.

Leon Snead & Company, P.C.
October 6, 2000

BLUE CROSS AND BLUE SHIELD OF NEW JERSEY
Final Administrative Cost Proposal
October 1, 1994 through September 30, 1995

Operation	Cost Claimed
Bills Payment	$2,671,300
Reconsiderations	397,563
Medicare Secondary Payer	1,294,480
Medical Review & Utilization	419,465
Provider Desk Reviews	881,057
Provider Field Audits	1,422,521
Provider Settlements	378,073
Provider Reimbursement	419,096
Productivity Investments	62,629
Benefit Integrity	153,996
Other	15,564
Credits/Other	(43,567)
Claimed administrative costs	$8,072,177
Questioned costs	(44,327)
Costs accepted	$8,027,850

BLUE CROSS AND BLUE SHIELD OF NEW JERSEY
Final Administrative Cost Proposal
October 1, 1995 through September 30,1996

Operation	Cost Claimed
Bills Payment	$2,753,257
Reconsiderations and Hearings	353,669
Medicare Secondary Payer	1,612,641
Medical Review and Utilization Review	401,172
Provider Desk Reviews	676,567
Provider Field Audit	1,476,205
Provider Settlements	376,279
Provider Reimbursement	299,302
Productivity Investments	0
Benefit Integrity	223,973
Other	0
Credits/Other	(222,833)
Claimed administrative costs	$7,950,232
Questioned costs	(41,652)
Costs accepted	$7,908,580

BLUE CROSS AND BLUE SHIELD OF NEW JERSEY
Final Administrative Cost Proposal
October 1, 1996 through September 30, 1997

Operation	Cost Claimed
Bills Payment	$2,941,161
Reconsiderations and Hearings	325,232
Medicare Secondary Payer	1,477,383
Medical Review and Utilization Review	456,817
Provider Desk Review	477,916
Provider Field Audits	1,747,583
Provider Settlements	489,835
Provider Reimbursement	302,082
Productivity Investments	185,038
Benefit Integrity	289,064
MIP Other	7,026
Credits/Other	(201,412)
Claimed administrative costs	$8,497,725
Questioned costs	(49,145)
Costs accepted	$8,448,580

RESULTS OF FOLLOW-UP ON PRIOR AUDIT REPORT

The audit report entitled "Audit of Medicare Part A Administrative Costs Claimed by Blue Cross Blue Shield of New Jersey for Fiscal Years 1990 through 1994" contained 19 findings related to BCBSNJ claims for administrative costs. Generally accepted government auditing standards and the Audit Guide for the Review of Administrative Costs Incurred by Medicare Intermediaries and Carriers Under Title XVIII of the Social Security Act requires follow-up on findings in prior audit reports. The purpose is to determine whether similar cost adjustments should be made in the current report or, in the case of procedural findings, whether adequate corrective action had been taken. Listed below is a synopsis of the findings in the prior report and the results of our follow-up work.

Excessive Executive Compensation

The prior audit recommended that $290,400 be removed from the cost claim because executive salary increases exceeded Employment Cost Index indices developed by the Department of Labor. The BCBSNJ in their response disagreed with the recommendation. The finding and recommendation have not been resolved.

Our follow-up for the period of this audit found that executive salary increases exceeded Employment Cost Index indices resulting in excessive allocation of $16,829. Additional details are in the Results of Audit section of this report.

External Computer Terminals

The prior audit report recommended that BCBSNJ make a downward financial adjustment of $102,045 to their cost claim and to improve their accounting system to more accurately identify external terminal costs and revenue related credits. The BCBSNJ response disagreed with the finding stating that costs for external terminals were not allocated to Medicare and accordingly revenue should not be either. The finding and recommendation have not been resolved.

During our follow-up, BCBSNJ told us that documentation would be provided supporting their assertions that external terminal costs were not allocated to Medicare. That documentation was not provided. Additional details are in the Results of Audit section of this report.

Accrued Moving Costs

The prior audit recommended a downward financial adjustment for unallowable moving fees of $78,526. BCBSNJ disagreed with the finding and recommendation. The finding and recommendation have not been resolved.

During our follow-up we tested moving cost transactions allocated to Medicare for 1 month for each of the 3 years audited. Our testing did not identify any discrepancies.

Financial Investigator Costs

The prior audit recommended a downward financial adjustment of $59,278 because of unallowable allocation of costs from a financial investigator cost center to Medicare. BCBSNJ disagreed with this finding. The finding and recommendation have not been resolved.

Our review found that the particular cost center was no longer used for financial investigator costs and had been reassigned as a Medicare direct cost center. Our analysis of cost centers and naturals accounts allocated to Medicare did not disclose any similar discrepancies.

Printing Services Cost Center

The prior audit recommended that a downward financial adjustment of $57,975 because of unallowable marketing costs allocated to Medicare from a printing service cost center (222). BCBSNJ disagreed with the finding and recommendation. The finding and recommendation have not been resolved.

Our review showed that Medicare was not allocated costs from cost center 222. In addition, we tested Print- Promotional and Print-General transactions. No discrepancies were noted.

Unallocated Credits

The prior audit report recommended that claimed administrative costs be reduced by $45,053 because Medicare was not allocated credits for BCBSNJ services to subsidiaries. BCBSNJ agreed with the recommendation.

Our current audit did not reveal any discrepancies.

Bank Fees

The prior audit report recommended that $36,868 be excluded from the cost claim because of unallowable bank account fees. BCBSNJ agreed with the finding and recommendation. Our review did not reveal any discrepancies.

Improper Cost Center Allocations

The prior audit report recommended that costs of $32,118 be deducted from claimed administrative costs because costs from 7 cost centers did not benefit Medicare. BCBSNJ disputed $20,481 of the amount. The finding and recommendation remain unresolved.

Our analysis for the current audit found that the cost centers were not allocated to Medicare.

Accounting Systems Finance Costs

The prior audit report recommended that $27,114 from cost center 085 be deducted from the cost claim. BCBSNJ concurred with the finding and recommendation.

For the current assignment there were no costs allocated to Medicare from cost center 085. Similarly, an analysis of other cost centers did not reveal any similar costs.

Chief Medical Officer

The prior report recommended that $26,772 related to the "Chief Medical Officer" cost center be deleted from the cost claim. BCBSNJ in their response maintained that the costs for that cost center were not allocated to Medicare. The finding and recommendation have not been resolved.

The analysis for the current assignment did not reveal any allocation to Medicare of costs associated with the Chief Medical Officer for the period FY1995 through FY1997.

Contract Development

The prior audit determined that $24,985 of costs from a "Contract Development" cost center was improperly allocated to Medicare and recommended that it be deleted from the cost claim. BCBSNJ concurred with the finding and recommendation.

The work performed during the current assignment did not reveal any allocation of costs from the Contract Development cost center.

Sales Related Expenses

The prior audit report recommended a downward financial adjustment of $19,523 related to selling expenses included on the FACP's. BCBSNJ disputed all but $369 of the recommended adjustment. The finding and recommendation have not been resolved.

The work performed on the current assignment did not reveal any allocations of costs to Medicare from the 3 cost centers related to selling expenses.

Legal Fees

The prior audit report recommended a downward financial adjustment of $16,959 related to unallowable outside legal charges. The BCBSNJ concurred with the recommendation and finding.

Our testing of transactions showed that costs were recorded for "Legal Charges" but were written off during preparation of the Final Administrative Cost Proposals.

Financial Audit Costs

The prior audit report recommended a downward financial adjustment of $14,545 applicable to the "Financial Audit" cost center. BCBSNJ disputed the finding. The finding and recommendation have not been resolved.

Our analysis of cost centers and natural account balances did not reveal allocations of costs to Medicare for this cost center or related accounts.

Subscriber and Actuarial Expenses

The prior report recommended a downward financial adjustment of $10,399 related to subscriber and actuarial expenses included on the Final Administrative Cost Proposals through oversight. BCBSNJ concurred with the finding and recommendation.

Our analysis of cost centers and natural accounts did not reveal costs allocated to Medicare for these categories.

Blue Cross & Blue Shield Association Charges

The prior report recommended a downward financial adjustment of $8,345 related to unallowable Blue Cross& Blue Shield Association consulting charges. BCBSNJ concurred with the finding and recommendation.

Our review of Blue Cross & Blue Shield Association costs did not reveal consulting charges allocated to Medicare.

Chairman of the Board Consulting Fees

The prior report recommended a financial adjustment of $6,845 related to payment of consultant fees to its Chairman of the Board. BCBSNJ disputed the finding in comments to the draft report but agreed with the exception after the issuance of the final report.

Our review of costs claimed for consulting fees did not reveal the allocation of costs to Medicare for consultant fees for the Chairman of the Board.

Other Non-Allocable Costs

The prior report recommended a downward financial adjustment of $7,101 for costs improperly allocated to Medicare. BCBSNJ agreed with all but $241 of the recommendation.

Our review showed that for the current audit costs were not allocated from the cost centers to Medicare. Our analysis of other cost centers did not detect allocations of similar costs.

BCBSNJ's Documentation of Expenses

The prior audit report recommended that BCBSNJ strengthen controls over its record keeping and record retention activities to ensure ready access to documentation supporting expenditures, accruals, and journal entries. BCBSNJ did not comment on the finding or recommendation.

During our review, we found that documenting transactions was time consuming and often required designing and implementing alternate procedures to ascertain the validity of the costs claimed.

For example, during the reconciliation of the FY1995 FACP to the accounting system we found that cost data for 2 of 10 Medicare lines of business had been mistakenly deleted. Similarly, copies of accounting system reports on microfiche had been destroyed. We were able to determine that the claimed costs were reasonable and allowable. However, it required significantly more time and effort to accomplish than if the records had been readily available.

Adequate documentation was provided to support transactions, however, only after a significant delay. We attribute the delays to a change to a different accounting system, personnel changes in the accounting functional area, and inadequate record keeping and retention policies and procedures.