DEPARTMENT OF HEALTH & HUMAN SERVICES

Office Of Inspector General
Office Of Audit Services

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

January 6, 2003

Our Reference: Report Number A-02-01-01009

Ms. Pamela Miller
Vice President, Government Strategic
Planning and Quality Management
Horizon Blue Cross Blue Shield of New Jersey
3 Penn Plaza
Newark, New Jersey 07105-2200

Dear Ms. Miller:

Enclosed are two copies of the U.S. Department of Health and Human Services, Office of Inspector General, Office of Audit Services' report entitled "REVIEW OF MEDICARE PART A ADMINISTRATIVE COSTS CLAIMED BY HORIZON BLUE CROSS BLUE SHIELD OF NEW JERSEY FOR THE PERIOD OCTOBER 1, 1997 THROUGH JULY 31, 2000." A copy of this report will be forwarded to the action official noted below for his review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. 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), 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 Report Number A-02-01-01009 in all correspondence relating to this report.

Sincerely yours,

Timothy J. Horgan
Regional Inspector General
for Audit Services

Enclosures

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF MEDICARE PART A ADMINISTRATIVE COSTS CLAIMED BY HORIZON BLUE CROSS BLUE SHIELD OF NEW JERSEY FOR THE PERIOD OCTOBER 1, 1997 THROUGH JULY 31, 2000

JANET REHNQUIST
Inspector General

JANUARY 2003
A-02-01-01009

Office of Inspector General

http://oig.hhs.gov

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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.

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Ms. Pamela Miller
Vice President, Government Strategic
Planning and Quality Management
Horizon Blue Cross Blue Shield of New Jersey
3 Penn Plaza
Newark, New Jersey 07105-2200

Dear Ms. Miller:

This report provides you with the results of our "REVIEW OF MEDICARE PART A ADMINISTRATIVE COSTS CLAIMED BY HORIZON BLUE CROSS BLUE SHIELD OF NEW JERSEY FOR THE PERIOD OCTOBER 1, 1997 THROUGH JULY 31, 2000."

The objective of our review was to determine whether administrative costs claimed by Horizon Blue Cross Blue Shield of New Jersey (Horizon) on its Medicare Part A Final Administrative Cost Proposals (FACP) covering the period October 1, 1997 through July 31, 2000 were allowable, allocable and reasonable.

Our audit disclosed that the $31,020,254 claimed for the period of our audit was overstated by $13,651. Our findings and recommendations are summarized below and are discussed in detail in the Findings and Recommendations section of this report. We found that Horizon's reported administrative costs included:

- $12,000 of employee training costs for services that did not benefit Medicare.
- $1,651 of excessive executive salaries and fringe benefits.

We are recommending that costs claimed by Horizon for the period October 1, 1997 through July 31, 2000 be reduced by $13,651.

Based on information provided by Horizon subsequent to the issuance of our draft report, this final report and Horizon's response (Appendix D) do not include two findings included in our draft report. In its response to the two remaining findings, Horizon accepted the disallowance of excessive executive salaries but did not concur with our recommended disallowance of employee training costs. However, we continue to maintain that the related training provided no benefit to Medicare and continue to recommend disallowance of those training costs.

INTRODUCTION

Background

Horizon, a subcontractor of the Blue Cross Blue Shield Association (BCBSA) was the Medicare Part A intermediary for the State of New Jersey during the period October 1, 1997 through July 31, 2000. In January 2000, Horizon invoked Article XXVIII of the Medicare contract that permits an intermediary to cancel its contract with six months notice. Specifically, Horizon announced that it would cease performing intermediary duties as of July 31, 2000. As a result of Horizon's decision to cancel its contract, the Final Administrative Cost Proposal (FACP) for fiscal year ended September 30, 2000 (FY 2000) contained normal on-going contract costs as well as transition costs stemming from the transfer of intermediary duties to the replacement contractor, Riverbend Government Benefits Administrator. From FY 1997 through FY 1999, Horizon claimed \$21,493,393 of administrative costs. On the FY 2000 FACP, Horizon claimed \$8,203,434 of on-going administrative costs as well as \$1,323,427 of transition costs. A separate report on Horizon's termination costs (expenses applicable to winding down the Medicare program after July 31, 2000) will be issued in the near future.

Objectives, Scope, and Methodology

Our examination was made in accordance with generally accepted government auditing standards. The objective of our review, which covered the period October 1, 1997 through July 31, 2000, was to determine whether costs claimed on the Final Administrative Cost Proposals submitted by Horizon were allowable, allocable, and reasonable in accordance with Appendix B of Horizon's Medicare contract ("Principles of Reimbursement for Administrative Costs") and the Provisions of Part 31 of the Federal Acquisition Regulations. Pension costs (\$129,051) and health insurance benefits for both current employees (\$1,457,370) and retired employees (\$243,547), which were included on Horizon's FACPs, will be the subject of a separate audit and therefore have been excluded from the scope of this review.

To accomplish our objective we: (1) performed a limited review of internal controls during which we obtained an understanding of the accounting policies and procedures relevant to the audit objectives; (2) reconciled costs claimed on the FACPs to Horizon's accounting records and; (3) judgmentally selected invoices, expense vouchers and journal entries for review; examined appropriate supporting documentation; and evaluated the reasonableness and propriety of cost allocations. In instances where the supporting documents were inconclusive or required further explanation, data analyses and inquiries of Horizon officials were conducted.

Our fieldwork was performed at Horizon's business office located at 3 Penn Plaza in Newark, New Jersey during the period February 2001 through May 2002.

FINDINGS AND RECOMMENDATIONS

Employee Training

Horizon improperly claimed $12,000 of unallowable employee training on its FACP for FY 2000. The purpose of the training was to provide employees who would lose their jobs as a result of Horizon's decision to cease being a Medicare contractor, instruction on resume preparation and career assistance. Section XV.A of Appendix B of the Medicare contract, specifically identifies as unallowable, "costs, which do not contribute to the Medicare agreement, contract". Since the training was prompted by Horizon's decision to opt-out of its Medicare contract and provided no benefit to Medicare, all related costs are unallowable and should be borne by Horizon.

Recommendation

We recommend a downward adjustment of $12,000 for unallowable employee training included on the FACP for FY 2000.

Horizon's Comments

Horizon did not concur with our recommended adjustment relating to employee training courses. They indicated the training involved resume preparation and related career assistance for employees transitioning out of the Medicare program. This training was offered to the Medicare employees in an effort to keep morale and confidence high during the transition period. Horizon also stated we made an erroneous argument in our draft report regarding Horizon's decision to "opt out" of the Medicare contract, and that we misunderstood their obligations to CMS. Horizon further stated they had no obligation to continue in the Medicare program and its decision to terminate or "opt out" was fully in accordance with the terms of the contract.

OAS Response

We maintain our opinion that these training costs provided no benefit to Medicare. We made no statement in our draft report that Horizon was obligated to continue in the Medicare program, or that their decision to terminate or opt out of the program was not in accordance with the contract. However, while it was Horizon's right to terminate its Medicare contract, we do not believe it is reasonable to expect Medicare to fund unnecessary costs resulting from Horizon's decision.

Executive Compensation

Horizon improperly included on the FACPs $1,651 of executive compensation paid to two employees in excess of allowable limits.

Section 31.205.6 of the FAR limits compensation of senior executives to an annual benchmark amount specified by the Administrator, Office of Federal Procurement Policy. The limitation is applicable to the top five corporate officials and top five employees within each company segment. The allowable compensation limits for these individuals, defined as total taxable wages plus elective deferrals before any allocations are applied, were $340,650 for FY 1998, $342,650 for FY 1999, and $353,010 for FY 2000.

Compensation for two executives, one in a corporate level position and one in an operational division level position, exceeded the allowable amounts. The excess amount, which was allocated to Medicare, was $1,130 in FY 1998 and $114 in FY 1999. We are also recommending disallowance of $407 of related fringe benefits ($364 in FY 1998 and $43 in FY 1999) applicable to the excessive salaries.

Recommendation

We recommend a downward adjustment of $1,651 for executive compensation in excess of the Federally prescribed limits and related fringe benefits. The downward adjustment effect on Part A FACPs submitted for the FYs 1998 through 2000 are as follows:

FY 1998	$1,494
FY 1999	157
Total	$1,651

Horizon's Comments

Horizon indicated they do not concede our reasons for the recommended disallowance relating to executive salaries but chose to accept the disallowance in light of the amount involved.

OTHER MATTERS

Y2K Costs

In April 2000, the Office of Audit, Office of the Inspector General, issued a report to HCFA on its examination of Y2K costs recorded by Horizon in interim expenditure reports (IER), for the period ended July 31, 1999. That report recommended for disallowance the following amounts:

- $18,354 of costs related to inaccurate time reporting.
- $21,649 of costs for Medicare supervisors who did not charge 100 percent of their time and effort to Y2K activities.
- $235,500 of "Other Direct Costs which were not incurred for Y2K remediation ($171,400) or which were claimed twice on the IER ($64,100).

We reviewed the specifics of these findings and determined that the only finding which could have resulted in excess amounts being claimed on the FACPs, was the $64,100 claimed twice on the IER. However, Horizon personnel provided us documentation showing that appropriate adjustments were made.

External Computer Terminals

The three preceding reports on audits of costs claimed on FACPs submitted by Horizon for prior years, all included a finding entitled "External Computer Terminals." Those audit findings involved Horizon's failure to appropriately reduce Medicare costs to reflect payments by hospitals for the use of Medicare funded computer terminals to transmit hospital claim information. Due to an ongoing appeal of those findings by Horizon, CMS has not been able to completely settle those FACP years. As part of our current audit, we again assessed whether Medicare received appropriate credits. In that regard, our review disclosed that during the current audit period, Medicare was not entitled to such credits. This change was due primarily to the advent of laptop computers and improvements in Horizon's accounting system that enabled us to ensure that Medicare no longer was allocated costs associated with computers provided to the hospitals.

APPENDICES

APPENDIX A

HORIZON BLUE CROSS BLUE SHIELD OF NEW JERSEY
Final Administrative Cost Proposal
October 1, 1997 through September 30, 1998

Operation	Total Claimed
Bills/Claims Payment	$2,929,693
Appeals/Reviews	261,466
Inquiries	708,529
Provider Education and Training	15,708
Reimbursement	612,107
Productivity Investment	124,964
Medical Review	700,807
Medicare Secondary Payer	1,037,427
Benefits Integrity	333,372
MIP Provider Education	49,117
Audit	3,051,703
Credit	(204,360)
TOTAL CLAIMED	$9,620,533
Costs Not Reviewed: [1]	
Pension Costs	(180,125)
Health Benefits – Current Employees	(500,670)
- Retired Employees	(111,384)
TOTAL CLAIMED COSTS SUBJECT TO REVIEW	$8,828,354
Recommended Audit Adjustment	(1,494)
BALANCE AFTER RECOMMENDED AUDIT ADJUSTMENT	$8,826,860

[1] The scope of our review did not include claimed pension and employee health benefits, which will be the subject of a subsequent review and report.

APPENDIX B

HORIZON BLUE CROSS BLUE SHIELD OF NEW JERSEY
Final Administrative Cost Proposal
October 1, 1998 through September 30, 1999

Operation	Total Claimed
Bills/Claims Payment	$2,854,523
Appeals/Reviews	177,200
Inquiries	793,338
Provider Education and Training	13,590
Reimbursement	618,098
Productivity Investment	2,276,700
Medical Review	826,806
Medicare Secondary Payer	1,004,162
Benefits Integrity	268,971
MIP Provider Education	55,361
Audit	3,172,139
Credit	(188,028)
TOTAL CLAIMED	$11,872,860
Costs Not Reviewed: [1]	
Pension Costs	(4,017)
Health Benefits – Current Employees	(473,197)
- Retired Employees	(78,620)
TOTAL CLAIMED COSTS SUBJECT TO REVIEW	$11,317,026
Recommended Audit Adjustment	(157)
BALANCE AFTER RECOMMENDED AUDIT ADJUSTMENT	$11,316,869

[1] The scope of our review did not include claimed pension and employee health benefits, which will be the subject of a subsequent review and report.

APPENDIX C

HORIZON BLUE CROSS BLUE SHIELD OF NEW JERSEY
Final Administrative Cost Proposal
October 1, 1999 through July 31, 2000

Operation	Total Claimed
Bills/Claims Payment	$2,586,875
Appeals/Reviews	146,433
Inquiries	726,887
Provider Education and Training	52,534
Reimbursement	544,170
Productivity Investment	0
Medical Review	654,802
Medicare Secondary Payer	877,457
Benefits Integrity	258,507
MIP Provider Education	528
Audit	2,511,931
Transition	1,323,427
Credit	(156,690)
TOTAL CLAIMED	$9,526,861
Costs Not Reviewed: [1]	
Pension Costs	55,091
Health Benefits – Current Employees	(483,503)
- Retired Employees	(53,543)
TOTAL CLAIMED COSTS SUBJECT TO REVIEW	$9,044,906
Recommended Audit Adjustment	(12,000)
BALANCE AFTER RECOMMENDED AUDIT ADJUSTMENT	$9,032,906

[1] The scope of our review did not include claimed pension and employee health benefits, which will be the subject of a subsequent review and report.

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MURPHY LLP
ATTORNEYS AT LAW

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DEC 24 2002

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December 23, 2002

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Timothy J. Horgan
Regional Inspector General for Audit Services
Office of Inspector General
Office of Audit Services
Region II
Jacob K. Javits Federal Building
26 Federal Plaza New York, NY 10278

Re: Review of Medicare Part A Administrative Costs Claimed By Horizon Blue Cross Blue Shield of New Jersey for the Period of October 1, 1997 through July 31, 2000

Dear Mr. Horgan:

This letter responds to the HHS Office of Inspector General's draft report entitled "Review of Medicare Part A Administrative Costs Claimed By Horizon Blue Cross Blue Shield of New Jersey for the Period of October 1, 1997 through July 31, 2000" (hereinafter "Draft Report" or "Report"). The Draft Report recommends that the $31,020,254 of administrative costs claimed by Horizon for the period from October 1, 1997 through July 31, 2000 be reduced by S13,641. Specifically, the Report recommends disallowances of $12,000 relating to employee training costs and $1,651 relating to executive salaries.[1]

Horizon disagrees with the recommended disallowance relating to employee training costs and sets out the bases for its disagreement below. Horizon does not concede the auditors'

[1] It is our understanding that your Office has withdrawn its previous recommended disallowances relating to (1) EDP costs and (2) transition bonus costs. As a result, those previous recommendations are not discussed in this letter.

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reasons for the recommended disallowance relating to executive salaries but chooses to accept the disallowance itself, in light of the amount involved.

Recommended Disallowance of $12,000 Relating to Employee Training Costs

The auditors recommend disallowance of $12,000 in employee training costs. The costs at issue were incurred to train employees transitioning out of the Medicare program in resume preparation and related career assistance. Horizon contracted for the training on behalf of its employees in an effort to keep morale and confidence high at a time when all of Horizon's Medicare employees would have to find new jobs. The rationale relied on by the auditors, that these costs did not "contribute to the Medicare agreement, contract," is short sighted and, when viewed in the totality of the circumstances surrounding the termination, flatly wrong.

The seamless transition and continuity of the Horizon's Medicare functions through the entire transition period was of utmost importance to the Medicare program. The continued performance, morale and support of the Horizon employees working on the transition effort was of utmost importance in this regard. CMS itself recognized this by approving a stay bonus award to Horizon's transition employees. Without the continuing dedication of Horizon's employees, Medicare's performance in the transition period would have suffered.

In the context of the transition and the reality that all of the Medicare employees had to look for new jobs, Horizon made a reasonable decision to offer career transition training to its Medicare employees in an effort to keep confidence levels and morale high. Such considerations clearly provide a basis for incurrence of allowable costs. See e.g., FAR 31.205-13 ("costs incurred on activities designed to improve . . . employer-employee relations, employee morale,

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and employee performance . . . are allowable); FAR 31.205-21 (labor relations costs allowable including costs incurred "in maintaining satisfactory relations between the contractor and its employees"). Moreover, the costs incurred were relatively *de minimus*, *i.e.*, only $12,000, in the context of the importance of properly transitioning the Medicare contract without any decrease in performance.

In addition, improving employee skills in career transition at this time when all Medicare employees faced such a transition may have made these employees more efficient (and potentially less distracted by their job searches) in performing their Medicare functions. The analysis of whether such costs are "reasonable" under the Medicare contract should include " a variety of considerations and circumstances, including . . . [t]he contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large." FAR 31.201-3(b)(3) (emphasis added).

Finally, the auditors proffer the totally erroneous argument that but for "Horizon's decision to opt-out of its Medicare contract" these costs would not have been incurred and therefore "provided no benefit to Medicare." This argument is based on a fundamental misunderstanding of Horizon's obligations to CMS. Contrary to the presumption made by the auditors, Horizon had no obligation whatsoever to continue in the Medicare program and its decision to terminate or "opt out" was fully in accordance with the terms of the Medicare contract. Such costs when related to a termination are subject to a lesser, rather than a greater, level of scrutiny. See e.g., *Appeal of Freedom Elevator Corp.*, GSBCA 7259, 85-2 BCA 17964 (1985) (the purpose of a termination settlement is to fairly compensate the contractor and make it whole for the costs it incurred in performing the terminated work); *Appeal of Tagarelli Brothers Construction Co.*, ASBCA 34793, 88-1 BCA 20363 (1987), *aff'd on reconsideration*, 88-2 BCA 20546 (1988) ("Federal regulators contemplate settlement of termination for convenience purposes by agreement, with business judgment, as distinguished from strict accounting purposes, as the heart of the settlement.").

Sincerely,

Bruce Shirk

W. Bruce Shirk

WBS:bct
Enclosure

cc Mr. Thomas Grippe (w/encl.) (via facsimile and Federal Express)
Pamela Miller, Esq. (w/enc.) (via facsimile and Federal Express)

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ACKNOWLEDGMENTS

This report was prepared under the direction of Timothy J. Horgan, Regional Inspector General for Audit services. Other principal Office of Audit Services staff who contributed include:

Thomas Grippe, *Audit Manager*
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