DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date . MAR 3 1 1993

From Bryan B. Mitchell
Principal Deputy Inspector General

Subject Report on the Audit of Administrative Costs Incurred Under Parts A and B of the Health Insurance for the Aged and Disabled Programs by Blue Cross and Blue Shield of Michigan (A-05-93-00013)

To William Toby, Jr.
Acting Administrator
Health Care Financing Administration

This memorandum alerts you to the issuance on April 2, 1993, of our final audit report. This report was prepared under an audit contract with the certified public accounting firm, Davis, Graves & Livingston, P.C. A copy is attached.

Administrative costs incurred by Blue Cross and Blue Shield of Michigan (BCBSM) for the period October 1, 1987 through September 30, 1989 under Parts A and B of the Health Insurance for the Aged and Disabled program contained amounts recommended for financial adjustment and costs set aside for further Health Care Financing Administration (HCFA) consideration of approximately $3.0 million and $4.2 million, respectively. Financial adjustments pertained to unallowable pension costs of $2,135,884; understated complementary insurance and miscellaneous income credit adjustments of $317,839; over allocations of technical support services, leased automatic data processing equipment and building occupancy costs of $269,795; unallowable subsidiary profit, interest, and legal fees of $214,756; and unallocable costs and return on investment charges of $72,642.

We are recommending that BCBSM make appropriate financial adjustments in these amounts. The auditee concurred with financial adjustments and set aside costs amounting to $2,434,145 and $4,248,743, respectively. The auditee did not agree with recommended adjustments totaling $576,771 for understated credits, over allocated building occupancy costs, and unallocable audit subcontract costs.

Regional HCFA officials generally concurred with the financial and procedural recommendations.

For further information, contact:
Martin D. Stanton
Regional Inspector General
for Audit Services, Region V
(312) 353-2618

Attachment

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REPORT ON THE AUDIT OF ADMINISTRATIVE COSTS INCURRED UNDER PARTS A AND B OF THE HEALTH INSURANCE FOR THE AGED AND DISABLED PROGRAM

BLUE CROSS AND BLUE SHIELD OF MICHIGAN

MARCH 1993 A-05-93-00013

DEPARTMENT OF HEALTH AND HUMAN SERVICES
REGION V
105 W. ADAMS ST.
CHICAGO, ILLINOIS 60603-6201

OFFICE OF
INSPECTOR GENERAL

Our Reference: Common Identification Number A-05-93-00013

Ms. Rosalee Livingston
Vice President, Government Business Group
600 Lafayette East
Detroit, Michigan 48226

Dear Ms. Livingston:

Enclosed for your information and use are two copies of an Office of Inspector General audit report titled "Report on the Audit of Administrative Costs Incurred Under Parts A and B of the Health Insurance for the Aged and Disabled Programs for the period October 1, 1987 through September 30, 1989. The report was prepared under audit contract with the CPA firm, Davis, Graves & Livingston, P.C. Your attention is invited to the audit findings and recommendations contained in the report.

Final determinations as to actions to be taken on all matters reported will be made by the Health and Human Services (HHS) official named below. The HHS action official will contact you to resolve the issues in this audit report. Any additional comments or information that you believe may have a bearing on the resolution of this audit may be presented at that time.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), Office of Inspector General reports issued to the Department's grantees or 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 the referenced common identification number in all correspondence relating to this report.

Sincerely,

Martin D. Stanton

Martin D. Stanton
Regional Inspector General
for Audit Services

Enclosures:

Direct reply to:

Judith Stec
Associate Regional Administrator
Division of Medicare

CONTRACT DISCLOSURES

This report is made pursuant to contract HHS-150-90-0011. The dollar amount of the contract with the Department of Health and Human Services, Office of Inspector General for work resulting in this report is not to exceed $ 83,808. The contract was awarded to Davis, Graves & Livingston, P. C. (Contractor) through a competitive bidding process. The names of the persons employed or retained by the contractor with managerial or professional responsibility for such work, or for the content of the report are as follows:

WALTER D. DAVIS, CPA

RODNEY L. GRAVES, CPA

ROSALIND BAKER, CPA

AUDITORS:

Davis, Graves & Livingston, P.C.
Certified Public Accountants
4500 Bissonnet, Suite 245
Bellaire, Texas 77401

DHHS PROJECT OFFICER

Mr. Paul Swanson
Department of Health & Human Services
Office of Inspector General
Office of Audit Services
105 W. Adams Street
Chicago Illinois 60603-6201
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SUMMARY OF FINDINGS

Blue Cross and Blue Shield of Michigan (Auditee) claimed administrative cost for Medicare, Part A and Part B, as follows:

	Fiscal Year		
	1988	1989	Total
Part A	$15,390,710	$14,388,795	$29,779,505
Part B	33,870,240	33,854,643	67,724,883
	$49,260,950	$48,243,438	$97,504,388

Our audit disclosed that the costs claimed and procedures followed were generally in accordance with the reimbursement principles and other provisions included in the Medicare agreements and Federal Acquisition Regulations, except for $ 7,259,659 of the $97,504,388 in administrative costs claimed by the Auditee during the period covered by our audit. We are recommending $3,010,916 for financial adjustment. At the request of the Project Officer, we did not audit $4,248,743 of subsidiary cost. Accordingly, we did not express an opinion on these costs, such amounts have been set aside for further consideration by HFCA officials. The remaining $90,244,729 is recommended for acceptance.

FINDINGS

The following is a summary of audit findings that are included in the report:

1. SUBSIDIARIES

During fiscal years 88 and 89, the Auditee charged Medicare for the cost of services provided by its wholly-owned for-profit subsidiaries amounting to $4,345,990. Included in the amount charged to Medicare was $195,565 in subsidiaries profits. Auditee eliminated $98,318 in profits from their Final Administrative Cost Proposals, however, the remaining amount of $ 97,247, we are recommending for financial adjustment. Based on a request from the Project Officer, we did not audit the remaining $4,248,743 in costs, accordingly, we are unable to express an opinion on the acceptability of these costs and have set them aside for further consideration by HCFA.

2. PENSION AND SPECIAL EARLY RETIREMENT PLAN

During fiscal year 1988 the Auditee charged Medicare for the cost of pension expense attributable to a Special Early Retirement Program (SERP).

It was determined that $2,135,884 of the claimed SERP pension expense was not computed or funded in accordance with applicable requirements and was unallowable for Medicare reimbursement.

3. **TECHNICAL SUPPORT AREAS**

Technical support center costs were billed to users, including Medicare, at rates less than actual cost of certain cost centers. The resulting residual amounts in these cost centers were then distributed to the users on a different cost allocation basis, resulting in overcharges to Medicare. In October 1988, the basis for distributing residual amounts was changed to the same basis used to bill users. As a result of this change a retroactive adjustment was made to the Final Administrative Cost Proposal for Fiscal Year 1988. However, the adjustment amount for the period October 1, 1987 through December 31, 1987 was not recorded. We are recommending for financial adjustment the net amount relating to the period, of $52,033.

4. **INTEREST ON NOTES PAYABLE**

The Auditee overcharged Medicare $110,648 for unallowable interest cost related to installment payments on a promissory note resulting from termination of leased equipment which required the Auditee to sign a promissory note for the termination cost.

Interest costs are unallowable per TITLE 48 CFR 31.205-20.

We determined that these payments included a total of $37,745 for FY 1988 and $75,161 for FY 1989 in interest costs. Medicare Part B was allocated 98 percent ($110,648) of these costs.

5. **LEASED EQUIPMENT - DISK STORAGE EQUIPMENT**

The Auditee leased certain Automated Data Processing Equipment (ADPE) from a subsidiary. The rent paid for this equipment and allocated to Medicare was greater than allowable under Federal Acquisition Regulations. As a result, excess costs of $24,146 were charged to Medicare in FY 1988.

6. **BUILDING OCCUPANCY - DUPLICATE UTILITY CHARGE**

Utility costs were allocated to Medicare in the months of October, November and December 1988 even though utility costs were included in the calculations of standard rate used in the compilation of occupancy costs. As a result of this duplication, Medicare was overcharged by $32,042.

7. **COMPLEMENTARY CREDITS**

The Auditee understated the amount of complementary credits applicable to Medicare during FY 1988 and FY 1989. The complementary credits reported in the Final Administrative Cost Proposal (FACP) was an estimated amount. The actual Complementary Credits exceeded the reported amount, as a result Medicare had not received $129,425 in applicable credits.

8. **ACCRUED SUBCONTRACT**

Auditee accrued and charged to Medicare Subcontract expense for auditing services that have not been performed. Generally accepted Accounting Principles require that expenses be recorded in the accounting period that actual obligations is incurred. The amount of such accrual is $65,316.

9. **RETURN ON INVESTMENT**

The Auditee applied the Return on Investment (ROI) to a parking lot facility that was no longer an asset of the Auditee. Since the assets was not used for Medicare purposes, the ROI amount claimed is unallowed. The total unallowable ROI cost claimed during FY 1988 and FY 1989 was $7,326.

10. **BUILDING OCCUPANCY DISTRIBUTION**

The Auditee overcharged Medicare by $193,616 in FY's 1988 and 1989. The Auditee failed to adjust the occupancy costs that were based on standard rate in order to bring it in line with actual costs.

11. **LEGAL FEES**

Legal fees were paid and charged to Medicare for the defense of the Auditee for litigations brought by the Federal Government including Health Care Financing Administration. However, because the case is still pending, we were not allowed to review documentations supporting the payments. The total amount questioned is $6,861.

12. **MISCELLANEOUS INCOME**

The Auditee received income for certain services that should have been credited to Medicare. Miscellaneous income is recorded in account 49250 under several suffixes used to identify source and types of income. We determined the amount of miscellaneous income allocable to Medicare in FY's 1988 and 1989 is to be $188,414.

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Davis, Graves & Livingston PC

Certified Public Accountants

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OPINION

We have audited the "Final Administrative Cost Proposals" (Forms HCFA 1523 and HCFA 1524) of Blue Cross and Blue Shield of Michigan for the fiscal years ended September 30, 1989, and 1988. These financial statements are the responsibility of Blue Cross and Blue Shield of Michigan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards, government auditing standards, and the "Guide for Audits of HCFA Programs and Activities (interim audit instruction E-1)'" dated May, 1981 and subsequent revisions. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We have identified $3,010,916 in costs recommended for financial adjustment and have recommended that $4,248,743 in costs be set-aside for further consideration by HCFA officials. The final determination as to whether such costs are allowable will be made by the United States Department of Health and Human Services.

In our opinion, with the exception of the effects of such adjustments resulting from the final resolution of the Set-Aside costs and the ultimate resolution of the costs recommended for financial adjustment, the "Final Administrative Cost Proposals" referred to above present fairly, in all material respects, the administrative costs

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applicable to Part A and Part B of the Health Insurance for the Aged and Disabled Program, claimed by Blue Cross and Blue Shield of Michigan for the fiscal years ended September 30, 1989 and 1988 in accordance with the reimbursement principles of Part 31 of the Federal Acquisition Regulations, as contained in 48 Code of Federal Regulations (CFR) Chapter (CH) 1, interpreted and modified by the Medicare Agreements.

Our audit was made for the purpose of forming an opinion on the financial statements included in the first paragraph. The supplemental information included in Schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the examination of the basic financial statements and, accordingly, we express no opinion on it.

This report is intended solely for the use of management of Blue Cross and Blue Shield of Michigan and the Department of Health and Human Services in regard to their agreement to administer the Medicare program and should not be used for any other purpose.

Davis, Graves & Livingston, P.C.

Davis, Graves & Livingston. P.C.
Bellaire, Texas 77401
February 1, 1991

INTRODUCTION

BACKGROUND

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled Program (Medicare). Overall responsibility for the administration of the Medicare program resides with the Secretary of the Department of Health and Human Services (DHHS). Within the Department, this responsibility has been delegated to Health Care Financing Administration (HCFA).

Part A of the program provides insurance protection against the costs of hospital and related care. The Medical Insurance Program-Part B-Supplementary Medical Insurance Benefits for the Aged and Disabled, is a voluntary program and provides protection against the cost of physicians services and other health services not covered under Part A.

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. Part A Intermediaries are nominated by provider groups. Nominations are submitted to HCFA, and agreements are entered into with approved Intermediaries.

Part A Intermediaries receive funds for payments to providers for the cost of service to eligible individuals and for the Intermediaries' administrative costs in operating the program. Carriers are reimbursed for all reasonable and allowable costs incurred in administering the Part B.

Blue Cross and Blue Shield of Michigan (hereafter referred to as the Auditee), a subcontractor with the Blue Cross and Blue Shield Association, serves as a Part A Intermediary and a Part B Carrier. Benefit payments were made in the following amounts:

	Fiscal Years	
	1989	1988
Part A	$ 2,251,076,358	$ 2,113,731,173
Part B	1,027,552,647	952,508,249

During the two year fiscal period October 1, 1987 through September 30, 1989, the auditee claimed $ 29,779,505 for administering Part A and $ 67,724,883 for Part B of the Medicare program.

Final Administrative Cost Proposals submitted are presented in Exhibits A, B, C, and D. In addition, comparative data related to benefits paid and administrative costs claimed during each of the reporting periods covered by the audit are presented in the "Analytical Review of Reported Costs".

SCOPE OF AUDIT

Our examination of the Administrative Costs of the Medicare Program was performed in accordance with financial and Compliance elements of the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions issued by the U.S. Comptroller General in June 1972 (1988 reprint), generally accepted auditing standards, and the prescribed Interim Audit Instruction E-1, Part I, revised May 1981 and HCFA reimbursed policies. The audit covered the period October 1, 1987 through September 30, 1989. Field work was performed during the period November 5, 1990 through February 1, 1991.

The primary purpose of the examination was to:

* Determine whether the contractor has established effective systems of internal accounting and reporting controls for administrative costs incurred under the program;

* Ascertain whether the final administrative cost proposals for the two FY's ended September 30, 1989 present fairly the costs of program administration allowable in accordance with Part 31 of the Federal Acquisition Regulations and Appendix B of the Medicare contracts;

* Follow up on the implementation and effectiveness of corrective action recommended in prior reports.

As a part of our audit of administrative costs, we tested the Plan's cost accumulation and allocation systems for accuracy and reasonableness, and reviewed the adequacy of supporting documentation of selected cost items. We also reviewed the procedures followed by the Plan in preparing the cumulative interim expenditure reports and the FACPs for the two years ended September 30, 1989.

Our audit did not include a review of the effectiveness or efficiency of the claims processing operations.

FINDINGS AND RECOMMENDATIONS

1. SUBSIDIARIES

In the prior three Medicare administrative cost audits, the audit firms were unable to offer an opinion on the Auditee's cost claimed for its wholly-owned for-profit subsidiaries. In summary, these firms reported:

(1) For the periods FY 80 through FY 83 the audit firm was unable to obtain sufficient documentation on subsidiaries' costs. Furthermore, they reported that one of the subsidiaries was charging profits on the services it provided the Auditee. As a result the audit firm offered no opinion on the acceptability of approximately $1.5 million in subsidiaries' costs and questioned the $150,000 related to profit.

(2) For the periods FY 84 through FY 85 the audit firm was directed by the Project Officer not to audit subsidiary costs. Accordingly, this firm offered no opinion on approximately $4.1 million in subsidiaries' costs and questioned the related profit of about $311,000.

(3) For the periods FY 86 through FY 87 the audit firm was directed by the Project Officer not to audit subsidiary costs. Accordingly, the firm offered no opinion on approximately $10.5 million in subsidiaries' costs and questioned the related profit of about $515,000.

During the current review, October 1, 1987 through September 30, 1989, we were directed by the Project Officer not to audit the subsidiaries' costs. According to the Project Officer, the subsidiaries' costs will be audited in a separate engagement. We were requested, however, to determine if profits were charged by the subsidiaries and allocated to Medicare.

SUBSIDIARY COSTS

We requested that the Auditee provide us with the amount of costs charged to Medicare for each of its subsidiaries for FY 88 and FY 89. The Auditee indicated that there were four subsidiaries that billed for their services during the audit period. However, the Auditee was unable to identify the specific amounts charged Medicare from each of the subsidiaries. We then agreed as in prior audits that the Auditee would identify the total billings from each of the subsidiaries to The Auditee.

Based on total billing from each subsidiary to The Auditee, the estimate of costs allocated to Medicare by the subsidiaries was determined on the application of the Medicare average allocation percentage to total cost billed by each subsidiary to The Auditee.

	Part A		Part B	
Subsidiary	FY 1989	FY 1988	FY 1989	FY 1988
HC Real Estate	$ -	545,011	-	1,099,533
Diversitec	107,275	627,483	251,642	1,265,893
Blue Ribbon	3,368	68,475	7,901	138,142
Tower Management	253	76,363	594	154,057
TOTAL	110,896	1,317,332	260,137	2,657,625

The total estimated costs charged to Medicare during FY 1989 and FY 1988 were $ 4,345,990. As previously stated, the Project Officer directed us not to audit these costs. Such costs will be addressed by a separate audit.

SUBSIDIARY PROFITS

Our review showed the Auditee had not eliminated all the profits included in the costs allocated to Medicare by the four subsidiaries. However, the Auditee had made a credit adjustment of $ 84,192 to the FY 1988 FACP and $ 14,126 to the FY 89 FACP. The Auditee applied a composite profit margin factor of 4.5% to the subsidiaries costs recorded in account 74503 that were charged to the Medicare line of business.

We calculated the amount of profits charged to Medicare by applying the profit margin factor used by the Auditee, to the total billings from each subsidiary to The Auditee.

	Part A		Part B	
Subsidiary	FY 1989	FY 1988	FY 1989	FY 1988
HC Real Estate	$ -	24,525	-	49,478
Diversitec	4,827	28,237	11,324	56,965
Blue Ribbon	151	3,081	355	6,216
Tower Management	11	3,436	27	6,932
TOTAL	4,989	59,279	11,706	119,591
Less: Auditee's Adjustment	6,366	26,702	7,760	57,490
Remaining Profit	<1,377>	32,577	3,946	62,101

According to the Medicare Agreement as well as the Auditee's subcontract agreements, only actual cost can be charges. As a result, we consider the remaining profit of $ 97,247 to be unallowable.

Of the total costs charged to Medicare from subsidiaries' billings, we offer no opinion on $ 4,248,743 (4,345,990 - 97,247) and question the remaining $ 97,247 in profits.

RECOMMENDATION

We recommend that the Auditee make the appropriate financial adjustment for profit, as follows:

	Part A		Part B		
	FY 1989	FY 1988	FY 1989	FY 1988	TOTAL
Subsidiary Profits	$<1,377>	32,577	3,946	62,101	97,247

AUDITEE RESPONSE

The Auditee agreed with the findings and recommended adjustment.

2. SPECIAL EARLY RETIREMENT PROGRAM (PENSION EXPENSE)

Auditee amended its pension plans in Fiscal Year 1988 with a Special Early Retirement Program (SERP) For fiscal year (FY) 1988, Auditee allocated approximately $3 million of SERP expense to Medicare and claimed the expense on its 1988 Final Administrative Cost Proposal (FACP). Auditee was reimbursed $2,135,884 of the claimed SERP pension expense.

As a result of a special audit performed by the Office of Inspector General, of Special Early Retirement Program Pension Cost claimed by Auditee, the entire amount reimbursed by Medicare was disallowed. Their report dated June 4, 1992 stated:

"Under CAS, the unfunded actuarial liability (UAL) of the SERP should have been amortized over 10 to 30 years as a component in determining pension costs for Medicare reimbursement rather than charging estimated costs in their entirety in one year" ... in order for even the lower assigned costs to be allowable for Medicare reimbursement, they must have been funded (contribution made to the plans) by the date specified by the FAR. Our review found that Auditee pension plans were not funded within the FAR specified time frame as it applies to 1988.

Therefore, pension costs, with the amortized UAL of the SERP as a component, are not allowable for 1988." We are in agreement with OIG conclusion which showed that the $2,135,884 was not computed or funded in accordance with applicable requirements. Both Auditee and Health Care Financing Administration agreed with their conclusions and recommendations. We recommend that the Auditee make the appropriate financial adjustments as follows:

	Part A	Part B
Fiscal Year 1988	$ 299,516	$ 1,836,368

AUDITEE RESPONSE

The Auditee agreed with the findings and recommended disallowance.

3. **TECHNICAL SUPPORT AREAS**

Technical support center costs were billed to users, including Medicare, at rates less than actual cost of certain cost centers. The resulting residual amounts in these cost centers were then distributed to the user. Prior to October 1988 residual amounts were distributed to the users on a different cost allocation basis, resulting in overcharges to Medicare. In October 1988, the basis for distributing residual amounts was changed to the same basis used to bill users. As a result of this change a retroactive adjustment was made to the Final Administrative Cost Proposal for Fiscal Year 1988.

However, the adjustment amount for the period October 1, 1987 through December 31, 1987 was not recorded. We are recommending for financial adjustment the net amount relating to the period, of $52,033.

AUDITEE RESPONSE

The Auditee agreed with the findings and recommended disallowance.

4. **INTEREST ON NOTES PAYABLE**

The Auditee overcharged Medicare $110,648 for unallowable interest cost related to installment payments on a promissory note.

In July 1985, the Auditee leased certain equipment from the Finalco Corporation.

These leases were subsequently purchased from Finalco Corporation by the Signal Corporation (Signal). In March 1987, the Auditee decided to terminate its lease on some of the equipment from Signal.

Under the terms of the lease agreement for the old equipment, the Auditee was required to pay certain termination costs. To cover the termination costs, the Auditee signed a promissory note with Signal as security. The terms of the note included 36 monthly payments of $61,441 and a principal amount of $2,039,022.

We determined that 98% of notes payments in FY 1988 and in FY 1989 were charged to Medicare Part B. We further determined that the notes payments included interest costs which were unallowable under Title 48 CFR 31.205-20.

> Title 48 CFR 31.205-20 States: Interest on borrowings (however represented), bond discounts, costs of financing and refinancing capital ..... are unallowable ....

We determined that these payments included interest costs totaling $37,745 for FY 1988 and $75,161 for FY 1989. Medicare part B was allocated 98% of these costs as follows:

	FY 1988	FY 1989	TOTAL
Part B	$36,990	$73,658	$110,648

RECOMMENDATION

We recommend that the Auditee make the appropriate financial adjustments as outlined above.

AUDITEE RESPONSE

The Auditee agreed with the findings and recommended disallowance.

5. LEASED EQUIPMENT - DISK STORAGE EQUIPMENT

Medicare was overcharged for lease payments by $28,750 in FY 1988 by allocating to Medicare lease payments in excess of costs allowable under Title 48 CFR 31.205-2 (b).

The Auditee leased certain Automated Data Processing Equipments (ADPE) from a subsidiary. In 1986, Tower Management, a subsidiary of the Auditee, purchased disk storage equipment from International Business Machines. The Auditee leased this equipment from Tower Management from September 1986 to August 1988.

Subsequently, the Auditee purchased the equipment from the subsidiary in September 1988.

We determined that the total lease costs was in excess of ownership costs allowable under TITLE 48 CFR 31.205-2, (b), (4) which states:

> ... allowable rental costs of ADPE leased from any division, subsidiary, or organization under a common control are limited to the cost of ownership (excluding interest or other costs unallowable under this subpart 31.2 and including the cost of money ...

In their comments to our draft report, the Auditee concurred in our finding but at a reduced amount. The Auditee believes the total lease payments made to Tower Management should be reduced by the 4.5% profit margin deducted from the subsidiary billings in Finding 1 of this report. After additional review, we agree with the Auditee and have recomputed the amount recommended for financial adjustment as follows:

Excess Lease Costs

Depreciation	$	663,974
ROI		187,527
Ownership Costs		851,501
Leased Cost Paid		1,131,000
Excess Lease Costs	$	279,499

* Total lease payments = $1,184,293, less 4.57% Profit Margin.

Using the average occupancy percentage, we computed the following excess applicable to Medicare as follows:

Excess Allocated to Medicare

Part A		
Average Rate	.04333 x $279,499 =	12,111
Part B		
Average Rate	.04306 x $279,499 =	12,035
	TOTAL	**$ 24,146**

RECOMMENDATION

We recommend that the Auditee make the appropriate financial adjustments, as follows:

	FY 1988
Part A	$12,111
Part B	12,035
TOTAL	**$24,146**

AUDITEE RESPONSE

The Auditee concurs in the finding and the revised amount recommended for financial adjustment.

6. **BUILDING OCCUPANCY - DUPLICATE UTILITY CHARGE**

Medicare was overcharged $32,042 in utility costs in FY 1989. Auditee used a standard square footage rate to distribute occupancy cost to each cost center. Occupancy cost was computed for the month by multiplying the net usable space by the standard foot rate. The standard rate charge included the cost of rent, depreciation, security, utilities, etc.

We determined that during the months of October, November and December 1988, utility costs totaling $32,042 were allocated to Medicare in addition to the regular occupancy costs allocation.

We questioned the additional utility costs allocated to Medicare since utility costs were already included in the computations of standard rates used in the allocations of occupancy costs.

AUDITEE RESPONSE

Blue Cross and Blue Shield of Michigan's occupancy distribution system called for all building service charges to be paid by HC Real Estate, a property management subsidiary of the Auditee. The building services costs, which included utility charges, were then billed to the Auditee by HC Real Estate. When the invoices were paid, the expenses were booked to cost center 09600, a control account. The total expenditures for 09600 were then used to develop a standard square footage rate to charge back occupancy costs to the various cost centers in each facility. However, during the period October - December 1988 utility invoices were routed directly to the Auditee for payment, bypassing HC Real Estate. The Auditee then paid the utility invoices booking the expense to cost centers 61270 and 61280. These expenses were then allocated to customers, including Medicare. Since the only cost center used to compute the occupancy cost distribution was 09600, the utility invoices charges to cost centers 61270 and 61280 were not added into the allocation base and therefore not double charged to Medicare.

AUDITOR RESPONSE

We reviewed additional documentation provided to us by the Auditee that showed the charges questioned were paid directly by the Auditee and recorded as stated. We also reviewed the occupancy distribution summaries for the period October - December 1988 and determined that charges questioned were not included in the total charges allocated. Therefore, we agree with Auditee and do not recommend any financial adjustment be made to occupancy expense.

7. **COMPLEMENTARY CREDITS**

Based on our review of specific cost centers identified by BCBSM's approved complementary credit plan, we identified actual allocations, as follows:

1989	Amount Per FACP	Amount Per Auditor	Difference
Part A	$ 989,890	$ 1,031,951	$ 42,061
Part B	1,321,021	1,452,838	131,817
	$ 2,310,911	$ 2,484,789	$ 173,878
1988			
Part A	$ 927,676	$ 1,003,407	$ 75,731
Part B	1,194,740	1,074,556	<120,184>
	$ 2,122,416	$ 2,077,963	$ <44,453>

Our review of complementary credit computation disclosed discrepancies between the amount reported in the Final Cost Administration Cost Proposal (FACP) and to us.

Based on our discussion with the Auditee's staff, we were told the amounts reported in the FACP did not represent complementary credits actually allocated to Medicare but were estimates.

RECOMMENDATION

Based on our computation, we recommend that the Auditee make the following financial adjustments:

	FY 1989	FY 1988
Part A	$ 42,061	$ 75,731
Part B	131,817	<120,184>
	$ 173,878	$ <44,453>

AUDITEE RESPONSE

The Auditee agrees that the Complementary Credit amounts shown on the 1523B and 1524B were lower than the actual allocations of Complementary Credits on the FACP. The data on these forms do not come directly from the allocations and is required to be computed separately. BCBSM's actual reporting of costs and credits to HCFA/Medicare are properly reflected on the FACP itself.

AUDITOR RESPONSE

As previously stated in our findings, amounts reported in the FACP did not represent complementary credits actually allocated to Medicare. We do not agree with Auditee's response that the amounts shown on the 1523B and the 1524B were lower than the actual allocations of complementary credits on the FACP. The amounts reported on the FACP and forms 1523B and 1524B did not agree with amounts computed by us or by the Auditee. Consequently, our recommendation remains unchanged .

8. **ACCRUED SUBCONTRACT**

Auditee accrued and charged to Medicare in FY 1989 subcontract expense for auditing services expected to be performed in the subsequent fiscal year. Although it appears that the Department of Health and Human Services allows for the accrual of such cost, generally accepted accounting principles require that expenses be recorded in the accounting period that the actual obligation is incurred.

We determined that the amount of accrued subcontract expense that is not in accordance with generally accepted accounting principles and charged to Medicare in FY 1989 is $65,316.

RECOMMENDATION

We recommend that the Auditee make the appropriate financial adjustment:

	FY 1989
Part A	$ 65,316

AUDITEE RESPONSE

The Auditee disagrees with the findings, but agrees with the accounting principle of GAAP. Auditee contends that HCFA instructed contractors to subcontract in fiscal year 1989 to maximum extent probable "even if the work is not completed until September 30, 1990, at the latest". The requirements were detailed in HCFA's letter of August 1989.

AUDITOR RESPONSE

The accrual of such expenses are not in accordance with generally accepted accounting principles. Additionally, the letter from HCFA stated, "In order for the funds to be obligated in FY 1989, all Notice of Budget Approvals for subcontract obligations must be reviewed in the office no later than September 20, 1989". The Auditee is unable to provide a NOBA for the accrued subcontracts as required by HCFA. After reviewing additional documentation from the Auditee, our basis for recommending financial adjustment remains unchanged.

9. **RETURN ON INVESTMENT**

The Auditee allocated $3,323 in FY 1988 and $ 4,003 in FY 1989 to Medicare for Return on Investment on an unallowable asset. Return on Investment (ROI) costs were charged to Medicare for a parking lot facility that was no longer an asset of the Auditee.

We computed the ROI on the parking lot facility based on the percentage allocated to Medicare from the respective cost centers, as follows:

Unallowable ROI = average net book value x average yield x Medicare percentage

	FY 1988	FY 1989	TOTAL
Parking Lot Facility	$ 3,323	$ 4,003	$ 7,326

RECOMMENDATION

We recommend that the Auditee make the appropriate financial adjustments as follows:

	FY 1988	FY 1989	TOTAL
Part A	$ 1,097	$ 1,201	$ 2,298
Part B	$ 2,226	$ 2,802	$ 5,028
	$ 3,323	**$ 4,003**	**$ 7,326**

AUDITEE RESPONSE

The Auditee agrees with the findings and recommendations.

10. **BUILDING OCCUPANCY DISTRIBUTION**

The Auditee overcharged Medicare by $193,616 in FY's 1988 and 1989 for building occupancy costs.

Generally, occupancy cost is distributed based on a standard rate per square foot. At the end of the calendar year when the actual cost is determined, the Auditee then prepares an analysis of actual costs versus distributed costs. The amount of over/under distributed occupancy costs are computed and adjustments are then made to bring the distributed costs in line with actual costs.

Our review revealed that in FY's 1988 and 1989, the Auditee did not adjust the occupancy costs that were based on a standard rate to bring it in line with actual costs. We recalculated the occupancy costs applicable to Medicare and we determined that Medicare was overcharged by $193,616.

RECOMMENDATION

We recommend that the Auditee make the appropriate financial adjustments as follows:

	FY 1989	FY 1988	TOTAL
Part A	$17,493	$40,937	$ 58,430
Part B	50,531	84,655	135,186
	$68,024	$125,592	$193,616

AUDITEE RESPONSE

The Auditee disagrees with the findings based on events in a subsequent fiscal period. The Auditee agreed with the Auditors that if Fiscal Years 1988 and 1989 are isolated and the occupancy charges calculated, this finding would be correct.

AUDITOR RESPONSE

Although an adjustment to occupancy expense distribution was made in a period subsequent to our audit period, our finding and recommended financial adjustment for fiscal year 1989 and 1988 remains valid. Each fiscal year is independent with HCFA closely monitoring the NOBA's. Accordingly, the Auditee should establish procedures to ensure that the necessary adjustments are identified in the fiscal year affected and that the applicable entries are made on the appropriate FACP.

11. **LEGAL FEES**

We questioned the legal fees charged to Medicare in the amount of $7,551 for FY's 1988 and 1989.

The amounts were paid to the law firm of Bodman & Longley for the defense of the Auditee for pending litigation brought by the federal government involving the Medicare Secondary Payer laws. The Health Care Financing Administration is also actively involved in the prosecution of the civil litigation.

We were not allowed to review the documentation supporting the payments or the circumstances surrounding the litigation because the case was pending.

In their comments to our draft report, the Auditee concurred in our finding but at a reduced amount. The Auditee believes that we used incorrect LOB rates to determine the amount charged to Medicare. After reviewing the additional information provided by the Auditee, we have recalculated the legal fees that were charged to medicare, as follows:

	FY 1988	FY 1989	TOTAL
Part A	$ 146	$ 2,226	$ 2,371
Part B	97	4,392	4,490
	$ 243	$ 6,618	$ 6,861

RECOMMENDATION

We recommend that the Auditee make the appropriate financial adjustments for $6,861.

AUDITEE RESPONSE

The Auditee concurs in the findings and the revised amount recommended for financial adjustment.

12. **MISCELLANEOUS INCOME CREDITS**

Auditee failed to credit to Medicare income received for certain services provided to the auditee's subsidiaries and others. We determined that a total amount of $188,414 should have been credited to Medicare during FY's 1988 and 1989.

Our examination revealed that miscellaneous income was recorded in account 49250 under several suffixes used to identify sources and types of income. The income represented reimbursements for administrative expenses incurred by Auditee for services provided to the auditee's subsidiaries and others. We noted that these reimbursements were not netted against the corresponding administrative expenses.

According to TITLE 48 CFR 31.201.5, applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the government either as a cost reduction or by cash refund.

Based on the above provision, we are of the opinion that the income should have been netted against the corresponding costs or the specific service provided.

We also noted and identified income amounts that were not related to Medicare; and computed the credits due to Medicare as follows:

	FY 1989	FY 1988
Total Miscellaneous Income in accounts 49250, 49240, & 49110	$ 8,669,223	$ 5,352,473
Less: Unrelated Accounts:		
HSC	<535,639>	<1,314,543>
PARKING GARAGE	<857,342>	< 600,640>
MMS	<235,009>	<1,214,187>
PROGRAM REIMBURSEMENT	<239,552>	< 253,119>
CUSTOMER REIMBURSEMENT	<130,982>	< 669,870>
OTHER MISC. INCOME	<162,798>	< 25,221>
Income Allocable to Medicare	$ 6,507,901	$ 1,274,893
Less: Income Allocated to Medicare:		
Special Allocation-Diversitec Related Revenue(EMC Income included in 49250 DIVICH)	<3,041,863>	< 0>
Special Allocation-Globe	< 40,595>	< 74,773>
Allocable Base for Adjustment	$ 3,425,443	$ 1,200,120
Cost Center Allocation by BCBSM	<4,075,473>	0
Over/Under Allocation to Medicare	**$ < 650,030>**	**$ 1,200,120**

Medicare Allocation

FY 1989

Part A: 3.75 % x $<650,030>= $<24,376>

Part B: 8.35 % x $<650,030>= $<54,277> + 40,595= $<13,682> *

FY 1988

Part A: 4.12 % x $ 1,200,120 = $ 49,444

Part B: 8.52 % x $ 1,200,120 = $ 102,250 + $74,773 = $177,023 *

* Revenue from GLOBE is included in Part B at 100%.

RECOMMENDATION

We recommend that the Auditee make the appropriate financial adjustments, as follows:

	FY 1988	FY 1989	TOTAL
Part A	$ 49,449	$<24,376>	$ 25,073
Part B	177,023	<13,682>	163,341
	$226,472	**$ <38,058>**	**$188,414**

AUDITEE RESPONSE

The Auditee agrees that certain revenues were not credited to Medicare in FY 1988 but contends that excess revenue was allocated to Medicare in FY 1989. Based on additional information provided subsequent to the completion of our audit field work, we revised our calculations and the amount recommended for financial adjustment. The Auditee agrees with our revised schedule and recommendations for FY 1988, however, they do not agree with the amounts calculated for FY 1989.

AUDITOR RESPONSE

Based on review of the additional information, we revised our finding to exclude certain other income items identified by the Auditee as being unrelated to Medicare. However, for fiscal year 1989 we continue to include $2,845,168 in revenue received by Diversitec. Although BCBSM contends that this amount should be excluded, we noted that this position was inconsistent with the Auditee's previous allocation for over $3 million in similar Diversitec revenues. We believe that Diversitec related revenues, totalling approximately $5.9 million, should be allocated to Medicare.

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COMMENTS ON EVALUATION OF INTERNAL CONTROL STRUCTURE

We have audited the Medicare Part A and Part B Statements of Administrative Costs of Blue Cross and Blue Shield of Michigan (the Auditee) for the fiscal years ended September 30, 1989 and 1988 and have issued our report thereon dated February 1, 1991.

We conducted our audit in accordance with generally accepted auditing standards and the standards for financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

In planning and performing our Audit of the Auditee, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

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

- Property and Equipment
- Cash Receipts
- Cash Disbursements
- Purchasing and Receiving
- Accounts Payable and Accrued Expenses
- Payroll

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

Our consideration of the internal control structure 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.

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A material weakness is a condition in which the design or operation of a specific internal control structure element does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the internal control structure and its operations that we considered to be material weaknesses as defined above.

The management of the Auditee is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system 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 financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to further periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

This report is intended solely for the use of management of Blue Cross and Blue Shield of Michigan and the Department of Health and Human Services in regard to their agreement to administer the Medicare program and should not be used for any other purpose.

Davis, Graves & Livingston, P.C.

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February 1, 1991

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COMMENTS ON COMPLIANCE WITH PERTINENT REGULATORY REQUIREMENTS

We have audited the "Final Administrative Cost Proposals" (Form HCFA 1523 and 1524) of Blue Cross and Blue Shield of Michigan (the Auditee) for the fiscal years ended September 30, 1989, and 1988, and have issued our report thereon dated February 1, 1991.

We conducted our audit in accordance with generally accepted auditing standards, government auditing standards, and the "Guide for Audits of HCFA Programs and Activities (interim audit instruction E-1);" dated May 1981 and subsequent revisions. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, grants, and binding policies and procedures applicable to Blue Cross and Blue Shield of Michigan is the responsibility of Blue Cross and Blue Shield of Michigan's management. As part of our audit, we performed tests of Blue Cross and Blue Shield of Michigan's compliance with certain provisions of laws, regulations, contracts, grants, and binding policies and procedures. However, it should be noted that we performed those tests of compliance as part of obtaining reasonable assurance about whether the financial statements are free of material misstatement; our objective was not to provide an opinion on compliance with such provisions.

Our testing of transactions and records selected from Federal programs disclosed instances of non compliance with those laws and regulations. All instances of noncompliance that we found and the programs to which they relate are identified in the Findings and Recommendations section of this report.

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Except as described above, the results of our test indicate that with respect to items tested, Blue Cross and Blue Shield of Michigan complied, in all material respects, with the provisions referred to in the third paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that Blue Cross and Blue Shield of Michigan had not complied, in all material respects, with those provisons.

This report is intended solely for the use of management of Blue Cross and Blue Shield of Michigan and the Department of Health and Human Services in regard to their agreement to administer the Medicare program and should not be used for any other purpose.

Davis, Graves & Livingston, P.C.

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February 1, 1991

OTHER MATTERS

Memo-FACP

The Auditee had submitted Memo-FACPs to HCFA for fiscal year 1988, for both Medicare Part A and Part B. These Memo-FACPs provided the total actual cost incurred for Medicare during the fiscal year. The total actual costs exceeded the amounts claimed on the FACP for the fiscal period in both Part A and Part B.

We were requested by HHS-OIG to include the total costs incurred in our audit tests. Appendix C and D provide amounts claimed on the FACP and the Memo-FACP amounts.

Changes in Administrative Costs

We have performed analytical reviews of the costs reported between fiscal years for both Medicare Part A and Part B. Results of these reviews are presented in the report section, "Interim Expenditure Reports".

Prior Audit Findings

The audit guide issued by the Department of Health and Human Services requests that we review the status of the prior auditor's findings and recommendations.

Our Review of prior audit findings revealed that all findings were satisfactorily resolved except for the following matter.

Complementary Credits - The auditee understated the amount of complementary credits applicable to Medicare during fiscal years 1986 and 1987. The complementary credit rate was not applied to all cost centers and certain subcontracts. Further, the Auditee computed the complementary credit rate, using an inappropriate rate reduction factor. As a result, Medicare had not received $456,557 in applicable credits.

We are recommending continued financial adjustment of the above mentioned amount until a final disposition is agreed to by the Auditee and HCFA.

INTERIM EXPENDITURE REPORTS

The audit guide issued by the Department of Health and Human Services requests that comment be included in the audit report concerning the accuracy of the Auditee's interim expenditure reports (IERs).

In order to determine the accuracy of these reports, we performed various tests for clerical accuracy and reliability of allocation methods and examined supporting costs reports which verified actual costs as reported on the IERs chosen for test work.

Based on the results of the work performed, it appears that the IERs are materially accurate.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
ANALYTICAL REVIEW OF REPORTED COSTS - PART A
FOR THE YEARS ENDED SEPTEMBER 30, 1989 AND 1988

OPERATIONS	Administrative Costs Claimed 1989	1988	Increase (Decrease) Amount	%	Ref
Bill Payment	$5,729,300	$5,315,646	$413,654	7.78%	
Reconsiderations & Hearing	280,233	425,174	(144,941)	-34.09%	1
Medicare Secondary Payer	1,296,280	1,102,354	193,926	17.59%	2
Medical & Utility Review	1,481,214	1,504,924	(23,710)	-1.58%	
Provider Desk Review	1,270,978	1,512,833	(241,855)	-15.99%	3
Provider Field Audit	2,137,502	2,326,510	(189,008)	-8.12%	
Provider Settlements	1,130,063	1,214,035	(83,972)	-6.92%	
Provider Reimbursements	948,178	1,209,588	(261,410)	-21.61%	4
Productivity Investments	115,047	342,300	(227,253)	-66.39%	5
Other - RTI Backlog	0	136,456	(136,456)		
Other - Pro Bill	0	300,890	(300,890)		
FACP Claimed Costs	$14,388,795	$15,390,710	($1,001,915)		

EXPLANATION OF SIGNIFICANT VARIANCES > 10% AND $50,000

PART A 1989 AND 1988

Note 1 RECONSIDERATIONS AND HEARINGS

Reconsideration and hearing costs decreased by $144,941 from 1988 to 1989 due to the reductions in abnormally high inventory and receipt workload volumes in 1988. The workload volume was 4,440 in 1988 compared to 1,728 in 1989.

Note 2 MEDICARE SECONDARY PAYER

The increase of $193,926 from FY 1988 to FY 1989 in Medicare secondary payer costs was due in large part to increase in data processing costs because of changes in distribution methodology in 1989.

Note 3 PROVIDER FIELD AUDIT

The numbers of desk reviews decreased by 259 from fiscal year 1988. Additionally SERP expenses were charged in fiscal year 1988 but were not during fiscal year 1989.

Note 4 PROVIDER REIMBURSEMENTS

SERP expenses were charged in fiscal year 1988 but not during fiscal year 1989. The number of reimbursements decreased by 22; No more freestanding HHA's and fewer providers on PIP (Periodic Interim Payment).

Note 5 PRODUCTIVITY INVESTMENTS

Productivity investments costs decreased by $227,253 in 1989. The fluctuation in productivity investment costs depends on projects as mandated by HCFA.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
ANALYTICAL REVIEW OF REPORTED COSTS - PART B
FOR THE YEARS ENDED SEPTEMBER 30, 1989 AND 1988

OPERATIONS	Administrative Costs Claimed 1989	1988	Increase (Decrease) Amount	%	Ref
Claims Payments	$20,041,605	$20,240,642	($199,037)	-0.98%	
Review & Hearings	3,615,141	4,000,640	(385,499)	-9.64%	1
Beneficiary/Phys. Inquiry	3,028,362	3,177,880	(149,518)	-4.70%	
Professional Relations	313,483	0	313,483		
Medical & Utility Review	3,621,267	3,306,419	314,848	9.52%	2
Medicare Secondary Payer	2,034,271	1,255,359	778,912	62.05%	3
Participating Physicians	658,221	748,000	(89,779)	-12.00%	4
Productivity Investments	334,593	949,700	(615,107)	-64.77%	5
Other	0	0			
Other	207,700	191,600	16,100	8.40%	
Other	0	0			
FACP Claimed Costs	$33,854,643	$33,870,240	($15,597)		

EXPLANATION OF SIGNIFICANT VARIANCES > 10% AND $50,000

PART B 1989 AND 1988

Note 1 REVIEWS AND HEARINGS

For two months of fiscal year 1988, clerical workforce was on strike and this function was performed by salaried staff which was more expensive to do so. Although the workload appears to have increase, there was a change in counting items from cases in fiscal year 1988 to claims in fiscal year 1989 which distorts the comparison of workloads

Note 2 MEDICAL REVIEW/UTILIZATION REVIEW

The increase of $314,848 in Medical Review/Utilization Review costs was due in part to staff increase required to meet larger HCFA mandated savings goals in 1989. The increase was also due to the change in the methodology used to distribute Data Processing Operation expenses instituted in 1989.

Note 3 MEDICARE SECONDARY PAYER

The increase of 62.05% reflected from 1988 to 1989 was due to increased HCFA funding because of the higher HCFA savings goals and also due to changes in Data Processing Cost distribution methodology in 1989.

Note 4 PARTICIPATING OF PHYSICIANS

The decrease in participating physicians costs was due in part to the physicians fees freeze and also due to the abnormal increase experienced in 1988.

Note 5 PRODUCTIVITY INVESTMENTS

As stated in the explanations of variances for the FY's 1987 and 1988, special projects are mandated by HCFA and as a result the cost fluctuates depending on the type of project. The significant decrease of 64.77% from 1988 to 1989 was due to the large funding received in 1988 for Reconciliation Provisions totaling $793,199 compared to $166,691 received in 1989.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
ANALYTICAL REVIEW OF REPORTED COSTS - PART A
FOR THE YEARS ENDED SEPTEMBER 30, 1988 AND 1987

OPERATIONS	Administrative Costs Claimed 1988	1987	Increase (Decrease) Amount	%	Ref
Bill Payment	$5,315,646	$5,119,077	$196,569	3.84%	
Reconsiderations & Hearing	425,174	216,382	208,792	96.49%	1
Medicare Secondary Payer	1,102,354	797,274	305,080	38.27%	2
Medical & Utility Review	1,504,924	1,721,779	(216,855)	-12.59%	3
Provider Desk Review	1,512,833	1,519,768	(6,935)	-0.46%	3
Provider Field Audit	2,326,510	2,017,585	308,925	15.31%	4
Provider Settlements	1,214,035	852,506	361,529	42.41%	5
Provider Reimbursements	1,209,588	1,082,995	126,593	11.69%	6
Productivity Investments	342,300	1,423,165	(1,080,865)	-75.95%	7
Other - RTI Backlog	136,456	195,636	(59,180)	-30.25	8
Other - Pro Bill	300,890	61,998	238,892	385.32	9
FACP Claimed Costs	$15,390,710	$15,008,165	$382,545		

EXPLANATION OF SIGNIFICANT VARIANCES > 10% AND $50,000

PART A 1988 AND 1987

Note 1 RECONSIDERATION HEARING

The cost of reconsiderations and hearings increased by $208,792 from 1987 to 1988 due to an abnormally high inventory and receipt workload volumes in 1988. Workloads for 1987 was 1,106 compared to 4,440 in 1988.

Note 2 MEDICARE SECONDARY PAYER

The increase of 38.27% represents an increase of $305,080 in Medicare secondary payer costs. The increase was due to increased HCFA funding due to higher HCFA savings goals.

Note 3 MEDICAL REVIEW/UTILIZATION REVIEW

Medical and utilization review costs reflect a decrease of $216,855 from 1987 and 1988. In 1988, funding for medical review/utilization review activity was sharply reduced at insistence of HCFA. Contracts had no choice but to reduce staffing.

Note 4 PROVIDER FIELD AUDIT

SERP expenses were charged in fiscal year 1988.

Note 5 PROVIDER SETTLEMENT

Increase in PPS settlements and reopenings; malpractice settlement reopenings increased; HHA reopening increased. SERP expenses were charges.

Note 6 PROVIDER REIMBURSEMENTS

SERP expenses were charged in fiscal year 1988.

EXPLANATION OF SIGNIFICANT VARIANCES > 10% AND $50,000

PART A 1988 AND 1987

-CONTINUED-

Note 7 PRODUCTIVITY INVESTMENTS

The significant decrease at 75.95% ($1,080,865) in productivity investment costs in 1988 was due largely to the high cost of installation at the California Part A System in 1987.

Note 8 OTHER - RTI BACKLOG

There was a backlog of PRO bill adjustments that was cleared in fiscal year 1988. In order to do the PRO adjustments, personnel were shifted from Return on Intermediary (RTI's) adjustments. The following year HCFA was concerned about the build up of RTI's and personnel were shifted back to RTI's.

Note 9 OTHER - PRO BILL

There was a backlog of PRO bill adjustments that was cleared in fiscal year 1988. In order to do the PRO adjustments, personnel were shifted from Return on Intermediary (RTI's) adjustments. The following year HCFA was concerned about the build up of RTI's and personnel were shifted back to RTI's.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
ANALYTICAL REVIEW OF REPORTED COSTS - PART B
FOR THE YEARS ENDED SEPTEMBER 30, 1988 AND 1987

OPERATIONS	Administrative Costs Claimed 1988	1987	Increase (Decrease) Amount	%	Ref
Claims Payments	$20,240,642	$18,371,277	$1,869,365	10.18%	1
Review & Hearings	4,000,640	2,505,326	1,495,314	59.69%	2
Beneficiary/Phys. Inquiry	3,177,880	4,964,971	(1,787,091)	-35.99%	3
Medical & Utility Review	3,306,419	3,023,224	283,195	9.37%	
Medicare Secondary Payer	1,255,359	730,448	524,911	71.86%	4
Participating Physicians	748,000	436,419	311,581	71.39%	5
Productivity Investments	949,700	527,925	421,775	79.89%	6
Other	191,600	185,490	6,110	3.29%	
Other	0	129,871	(129,871)		
FACP Claimed Costs	$33,870,240	$30,874,951	$2,995,289		

EXPLANATION OF SIGNIFICANT VARIANCES > 10% AND $50,000

PART B 1988 AND 1987

Note 1 CLAIMS PAYMENT

The 10.18% increase in claims payment from 1987 to 1988 was due to 12% increase in volume of claims processed in 1988.

Note 2 REVIEWS AND HEARINGS

Reviews and Hearing costs increased by 59.69% ($1,495,314) from 1987 to 1988. In 1988, HCFA allowed a combined unit cost of $12.71 which was significantly higher than the $7.81 allowed in 1987.

Note 3 BENEFICIARY/PHYSICIANS INQUIRY

Beneficiary/physician inquiry costs decreased by 35.99% ($1,787,091) from 1987 to 1988 due to significantly high level of actual inquiry volume in 1987. Actual inquiry volume was 616,959 in 1987 compared to 304,416 in 1988.

Note 4 MEDICARE SECONDARY PAYER

Medicare secondary Payer costs increased by 71.86% in 1988 because of the increased savings goal. The savings goal increased by 26% in 1988.

Note 5 PARTICIPATING OF PHYSICIANS

Participating physicians costs increased significantly (71.39%) from 1987 to 1988 due to HCFA delays in communication of the 1988 PAR enrollment process to providers, thereby resulting in multiple mailings causing confusion and many inquiries throughout the provider community.

Note 6 PRODUCTIVITY INVESTMENTS

Generally, special projects are mandated by HCFA each year which leads to fluctuations depending on the type of project. In 1988, funding totaling $793,100 was received for Reconciliation provisions which accounted for the significant increase in productivity investment costs in 1988.

EXIT CONFERENCE

An exit conference via telephone was conducted on October 6, 1992. Those participating were:

Lou Gorning	Director of Gov. Budget & Reporting	Blue Cross/Blue Shield
James Zoladz	Manager Gov. Relations	Blue Cross/Blue Shield
Valerie Keese	Manager Cost Acct.	Blue Cross/Blue Shield
Norm Schwieger	Lead Cost Analyst	Blue Cross/Blue Shield
Peggy Smith	Audit Analyst	Blue Cross/Blue Shield
Walter D. Davis	Partner	Davis, Graves & Livingston P.C.
Louis Nealy	Manager	Davis, Graves & Livingston P.C.

The findings and Recommendations as reported in this audit report were discussed.

EXHIBIT A

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
FINAL ADMINISTRATIVE COST PROPOSAL
COST INCURRED, CLAIMED AND UNFUNDED
BY OPERATION - PART A
FOR THE YEARS ENDED SEPTEMBER 30, 1989

PART A	FACP COST CLAIMED	RECOMMENDED ADJUSTMENTS	NO OPINION EXPRESSED
Bill Payment	$5,729,300		
Reconsiderations & Hearings	280,233		
Medical Secondary Payer	1,296,280		
Medical and Utility Review	1,481,214		
Provider Desk Review	1,270,978		
Provider Field Audits	2,137,502		
Provider Settlements	1,130,063		
Provider Reimbursements	948,178		
Productivity Investments	115,047		
Total Costs	$14,388,795	$102,544 (b)	112,273 (b)
Total Funds Withdrawn	$14,874,300		
Over Funded Amount (a)	($485,505)		

(a) Represents amount in excess of amounts claimed.

(b) Represent costs recommended for adjustment and set aside; details related to these items are provided on schedule 1.

EXHIBIT B

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
FINAL ADMINISTRATIVE COST PROPOSAL
COST INCURRED, CLAIMED AND UNFUNDED
BY OPERATION - PART B
FOR THE YEARS ENDED SEPTEMBER 30, 1989

PART B	FACP COST CLAIMED	RECOMMENDED ADJUSTMENTS	NO OPINION EXPRESSED
Claims Payment	$20,041,605		
Reviews & Hearings	3,615,141		
Beneficiary/Phys. Inquiry	3,028,362		
Professional Relations	313,483		
Medical and Utility Review	3,621,267		
Medicare Secondary Payer	2,034,271		
Participating Physicians	658,221		
Productivity Investments	334,593		
Other	207,700		
Total Costs	$33,854,643	$253,464 (b)	256,191 (b)
Total Funds Withdrawn	$33,799,100		
Over Funded Amount (a)	$55,543		

(a) Represents amount claimed but not withdrawn from the letter-of-credit.

(b) Represent costs recommended for adjustment and set aside; details related to these items are provided on schedule 2.

EXHIBIT C

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
FINAL ADMINISTRATIVE COST PROPOSAL
COST INCURRED, CLAIMED AND UNFUNDED
BY OPERATION - PART A
FOR THE YEARS ENDED SEPTEMBER 30, 1988

PART A	MEMO FACP	COST NOT CLAIMED	FACP COST CLAIMED	RECOMMENDED ADJUSTMENTS	NO OPINION EXPRESSED
Bill Payment	$7,134,254	$1,818,608 (a)	$5,315,646		
Reconsiderations & Hearings	467,100	41,926 (a)	425,174		
Medical Secondary Payer	1,102,354		1,102,354		
Medical and Utility Review	1,504,924		1,504,924		
Provider Desk Review	1,512,833		1,512,833		
Provider Field Audits	2,326,510		2,326,510		
Provider Settlements	1,214,035		1,214,035		
Provider Reimbursements	1,209,588		1,209,588		
Productivity Investments	342,300		342,300		
Other - RTI Backlog	136,456		136,456		
Other - Pro Bill	300,890		300,890		
Total Costs	$17,251,244	$1,860,534	$15,390,710	425,493 (c)	1,284,755 (c)
Total Funds Withdrawn			$14,281,500		
Unfunded Amount			(b) $1,109,210		

(a) Represents excess amounts of costs based on agreement over actual costs claims. The amounts not claimed were included in the audit tests. However, we do not recommend these amounts be accepted or set aside because these amounts were not claimed.

(b) Represent amounts claimed but not withdrawn from the letter-of-credit.

(c) Represent costs recommended for adjustment and set aside; details related to these items are provided on schedule 3.

EXHIBIT D

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
FINAL ADMINISTRATIVE COST PROPOSAL
COST INCURRED, CLAIMED AND UNFUNDED
BY OPERATION - PART B
FOR THE YEARS ENDED SEPTEMBER 30, 1988

PART B	MEMO FACP	COST NOT CLAIMED	FACP COST CLAIMED	RECOMMENDED ADJUSTMENTS	NO OPINION EXPRESSED
Claims Payment	$20,240,642		$20,240,642		
Reviews & Hearings	4,004,326	3,686 (a)	4,000,640		
Beneficiary/Phys. Inquiry	3,476,977	299,097 (a)	3,177,880		
Medical and Utility Review	3,306,419		3,306,419		
Medicare Secondary Payer	1,255,359		1,255,359		
Participating Physicians	748,000		748,000		
Productivity Investments	949,700		949,700		
Other- Carrier Incentives	191,600		191,600		
Total Costs	$34,173,023	$302,783	$33,870,240	$2,229,415 (c)	2,595,504 (c)
Total Funds Withdrawn			$14,281,500		
Unfunded Amount			(b) $19,588,740		

(a) Represents excess amount of costs based on agreement over actual costs claimed. The amounts not claimed were included in the audit tests. However, we do not recommend these amounts be accepted or set aside because these amounts were not claimed.

(b) Represents amounts claimed but not withdrawn from the letter-of-credit.

(c) Represent costs recommended for adjustment and set aside; details related to these items are provided on schedule 4.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
COST CLAIMED PER
FINAL ADMINISTRATIVE COST PROPOSAL
AND RELATED AUDITOR RECOMMENDATIONS
BY OPERATION - PART A
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1989

ADJ. NO.	DESCRIPTION	BILL PAYMENTS	RECONSID. HEARINGS	MEDICARE SECONDARY	MEDICAL & UTILITY REVIEW	PROVIDER DESK REVIEWS	PROVIDER FIELD AUDITS	PROVIDER SETTLEMENTS	PROVIDER REIMBUR-SEMENT	PRODUCTIVITY INVESTMENTS	TOTAL
	FACP COST CLAIMED	5,729,300	280,233	1,296,280	1,481,214	1,270,978	2,137,502	1,130,063	948,178	115,047	14,388,795
	SET ASIDE COSTS:										
1	SUBSIDIARY COST	44,909	2,218	9,981	11,227	8,872	17,308	8,872	7,763	1,123	112,273
	SUBTOTAL	5,684,391	278,015	1,286,299	1,469,987	1,262,106	2,120,194	1,121,191	940,415	113,924	14,276,522
	COST RECOMMENDED FOR ADJUSTMENT:										
2	ACCRUED SUBCONTRACT	20,192	198	171	957	13,824	27,776	930	1,268	0	65,316
3	RETURN ON INVESTMENT	480	24	108	121	96	180	96	84	12	1,201
4	BUILDING OCCUPANCY DISTRIBUTION	5,756	427	1,777	2,046	1,639	2,807	1,524	1,316	201	17,493
5	SUBSIDIARY PROFITS	(551)	(28)	(124)	(138)	(110)	(206)	(110)	(96)	(14)	(1,377)
6	LEGAL FEES	536	62	256	295	236	404	219	189	29	2,226
7	MISC. INCOME	(8,020)	(596)	(2,476)	(2,850)	(2,284)	(3,912)	(2,124)	(1,834)	(280)	(24,376)
8	COMPLEMENTARY CREDIT	42,061									42,061
	TOTAL ADJUSTMENTS	60,454	87	(288)	431	13,401	27,049	535	927	(52)	102,544
	COST ACCEPTED	5,623,937	277,928	1,286,587	1,469,556	1,248,705	2,093,145	1,120,656	939,488	113,976	14,173,978

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
COST CLAIMED PER
FINAL ADMINISTRATIVE COST PROPOSAL
AND RELATED AUDITOR RECOMMENDATIONS
BY OPERATION - PART A
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1989

ADJ. #	EXPLANATION OF ADJUSTMENTS
1.	Represents costs set aside that are related to the cost of goods and services purchased from subsidiaries, net of subsidiary profits.
2.	Represents accrual of subcontract costs that were not in accordance with generally accepted accounting principles. These costs are allocated by operation based on where the costs were originally charged.
3.	Represents Return on Investment on parking lot facility. These costs are allocated on a pro rata basis based on the FACP personal service costs.
4.	Represents the Building occupancy costs overcharged to Medicare. These costs are allocated on a pro rata basis based on the FACP personal service costs.
5.	Represents subsidiaries' profits charged to Medicare.
6.	Represents legal costs charged to Medicare without documentation. These costs are allocated on a pro rata basis based on the FACP personal service costs.
7.	Represents miscellaneous income credits. This adjustment is allocated on a pro rata basis on the FACP personal service costs.
8.	Represents the Complementary Credit Adjustment. These costs were allocated one-hundred percent to the claims payment operation.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
COST CLAIMED PER
FINAL ADMINISTRATIVE COST PROPOSAL
AND RELATED AUDITOR RECOMMENDATIONS
BY OPERATION - PART B
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1989

ADJ. NO.	DESCRIPTION	CLAIMS PAYMENT	REVIEW HEARINGS	BENEFIC./ PHYSICIAN INQUIRY	PROFES'L. RELATIONS	MEDICAL & UTILITY REVIEW	MEDICARE SECONDARY PAYER	PARTICI-PATING PHYSICIANS	PRODUCTIVITY INVESTMENTS	OTHERS	TOTAL
	FACP COST CLAIMED	20,041,605	3,615,141	3,028,362	313,483	3,621,267	2,034,271	658,221	334,593	207,700	33,854,643
	SET ASIDE COSTS:										
1	SUBSIDIARY COST	151,153	28,181	23,057	2,562	28,181	15,371	5,124	2,562		256,191
	SUBTOTAL	19,890,452	3,586,960	3,005,305	310,921	3,593,086	2,018,900	653,097	332,031	207,700	33,598,452
	COST RECOMMENDED FOR ADJUSTMENT:										
2	INTEREST ON NOTE PAYABLE	37,809	10,139	7,376	640	9,876	5,003	1,248	1,027	540	73,658
3	SUBSIDIARY PROFITS	2,328	434	356	39	434	237	79	39		3,946
4	COMPLEMENTARY CREDIT	131,817									131,817
5	RETURN ON INVESTMENT	1,654	308	252	28	308	168	56	28		2,802
6	BUILDING OCCUPANCY										0
	DISTRIBUTION	25,938	6,955	5,060	439	6,775	3,432	856	705	371	50,531
7	LEGAL FEES	2,060	660	480	42	642	325	81	67	35	4,392
8	MISC. INCOME	(7,023)	(1,883)	(1,370)	(119)	(1,834)	(929)	(232)	(191)	(100)	(13,682)
	TOTAL ADJUSTMENTS	194,583	16,613	12,154	1,069	16,201	8,236	2,088	1,675	846	253,464
	COST ACCEPTED	19,695,869	3,570,347	2,993,151	309,852	3,576,885	2,010,664	651,009	330,356	206,854	33,344,988

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
COST CLAIMED PER
FINAL ADMINISTRATIVE COST PROPOSAL
AND RELATED AUDITOR RECOMMENDATIONS
BY OPERATION - PART B
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1989

ADJ. #	EXPLANATION OF ADJUSTMENTS
1.	Represents costs set aside that are related to the cost of goods and services purchased from subsidiaries, net of subsidiary profits.
2.	Represents unallowable interest costs charged to Medicare. These costs are allocated on a pro rata basis based on the FACP personal service costs.
3.	Represents subsidiaries' profits charged to Medicare.
4.	Represents the Complementary Credit Adjustment. These costs were allocated one-hundred percent to the claims payment operation.
5.	Represents Return on Investment on parking lot facility. These costs are allocated on a pro rata basis based on the FACP personal service costs.
6.	Represents the Building occupancy costs overcharged to Medicare. These costs are allocated on a pro rata basis based on the FACP personal service costs.
7.	Represents legal costs charged to Medicare without documentation. These costs are allocated on a pro rata basis based on the FACP personal service costs.
8.	Represents miscellaneous income credits. This adjustment is allocated on a pro rata basis on the FACP personal service costs.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
COST CLAIMED PER
FINAL ADMINISTRATIVE COST PROPOSAL
AND RELATED AUDITOR RECOMMENDATIONS
BY OPERATION - PART A
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1988

ADJ. NO.	DESCRIPTION	BILL PAYMENTS	RECONSID. HEARINGS	MEDICARE SECONDARY	MEDICAL & UTILITY REVIEW	PROVIDER DESK REVIEWS	PROVIDER FIELD AUDITS	PROVIDER SETTLEMENTS	PROVIDER REIMBUR-SEMENT	PRODUCTIVITY INVESTMENTS	OTHER RIT BACKLOG	OTHER PRO BILL	TOTAL
	FACP COST CLAIMED	5,315,646	425,174	1,102,354	1,504,924	1,512,833	2,326,510	1,214,035	1,209,588	342,300	136,456	300,890	15,390,710
	SET ASIDE COSTS:												
1	SUBSIDIARY COST	449,650	38,543	89,935	128,478	128,478	192,716	102,782	89,935	25,695	12,848	25,695	1,284,755
	SUBTOTAL	4,865,996	386,631	1,012,419	1,376,446	1,384,355	2,133,794	1,111,253	1,119,653	316,605	123,608	275,195	14,105,955
	COST RECOMMENDED FOR ADJ.												
2	STORAGE DISK	6,226	0	2,516	3,369	0	0	0	0	0	0	0	12,111
3	TECHNICAL SUPPORT	(30,125)	(2,582)	(6,025)	(8,607)	(8,607)	(12,911)	(6,886)	(6,025)	(1,721)	(861)	(1,721)	(86,071)
4	SUBSIDIARIES PROFIT	11,402	977	2,280	3,258	3,258	4,886	2,606	2,280	652	326	652	32,577
5	RETURN ON INVESTMENT	384	33	77	110	110	165	88	77	21	11	21	1,097
6	SERP PENSION COST			59,671	60,163	67,610			10,838	101,234			299,516
7	BLDG. OCCUPANCY DIST.	12,101	1,367	3,567	4,776	4,212	6,278	3,558	3,411	672	302	693	40,937
8	COMPLEMENTARY CREDIT	75,731											75,731
9	LEGAL FEES	42	6	14	18	15	20	14	14	1	1	1	146
10	MISC. INCOME	14,617	1,652	4,308	5,769	5,088	7,584	4,298	4,120	812	365	837	49,449
	TOTAL ADJUSTMENTS	90,378	1,453	66,408	68,856	71,686	6,022	3,678	14,715	101,671	144	483	425,493
	COST ACCEPTED	4,775,618	385,178	946,011	1,307,590	1,312,669	2,127,772	1,107,575	1,104,938	214,934	123,464	274,712	13,680,462
11	COST NOT CLAIMED	1,818,608	41,926										1,860,534

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
COST CLAIMED PER
FINAL ADMINISTRATIVE COST PROPOSAL
AND RELATED AUDITOR RECOMMENDATIONS
BY OPERATION - PART A
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1988

ADJ. #	EXPLANATION OF ADJUSTMENTS
1.	Represents costs set aside that are related to the cost of goods and services purchased from subsidiaries, net of subsidiary profits.
2.	Represents lease payment costs overcharged to Medicare. These costs are allocated by operations based on where the costs were originally charged.
3.	Represents the Technical Support Area adjustments of residual amounts.
4.	Represents subsidiaries' profits charged to Medicare.
5.	Represents Return on Investment on parking lot facility. These costs are allocated on a pro rata basis based on the FACP personal service costs.
6.	Represents cost of pension expense attributable to the Special Early Retirement Program (SERP).
7.	Represents the Building occupancy costs overcharged to Medicare. These costs are allocated on a pro rata basis based on the FACP personal service costs.
8.	Represents the Complementary Credit Adjustment. These costs were allocated one-hundred percent to the claims payment operation.
9.	Represents legal costs charged to Medicare without documentation. These costs are allocated on a pro rata basis based on the FACP personal service costs.
10.	Represents miscellaneous income credits. This adjustment is allocated on a pro rata basis on the FACP personal service costs.
11.	This is the excess amount of costs incurred above costs claimed by the Auditee. The total costs not claimed were amounts expended in excess of the negotiated fixed rate per claim.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
COST CLAIMED PER
FINAL ADMINISTRATIVE COST PROPOSAL
AND RELATED AUDITOR RECOMMENDATIONS
BY OPERATION - PART B
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1988

ADJ. NO.	DESCRIPTION	CLAIMS PAYMENTS	REVIEW HEARINGS	BENEFIC. PHYSICIAN INQUIRY	PROFES'L RELATIONS	MEDICAL & UTILITY REVIEW	MEDICARE SECONDARY PAYER	PARTICI-PATING PHYSICIANS	PRODUCTIVITY INVESTMENTS	OTHERS	TOTAL
	FACP COST CLAIMED	20,240,642	4,000,640	3,177,880	0	3,306,419	1,255,359	748,000	949,700	191,600	33,870,240
	SET ASIDE COSTS:										
1	SUBSIDIARY COST	1,557,302	311,460	233,596	0	259,550	103,821	51,910	77,865		2,595,504
	SUBTOTAL	18,683,340	3,689,180	2,944,284	0	3,046,869	1,151,538	696,090	871,835	191,600	31,274,736
	COST RECOMMENDED FOR ADJ.										
2	NOTES PAYABLE	27,286	0	0	0	6,824	2,880	0	0	0	36,990
3	STORAGE DISK	8,276	0	0	0	2,643	1,116	0	0	0	12,035
4	SUBSIDIARY PROFITS	37,261	7,452	5,589		6,210	2,484	1,242	1,863		62,101
5	TECHNICAL SUPPORT	82,862	16,573	12,429		13,810	5,524	2,762	4,144		138,104
6	SERP PENSION COST	1,215,557				156,184	0	160,590	304,037	0	1,836,368
7	RETURN ON INVESTMENT	1,336	267	200		223	89	45	66		2,226
8	COMPLEMENTARY CREDIT	(120,184)									(120,184)
9	BLDG. OCCUPANCY DIST.	42,216	13,108	8,764		10,557	4,456	2,185	2,613	756	84,655
10	LEGAL FEES	40	15	11		13	8	4	5	1	97
11	MISC. INCOME	88,278	27,410	18,326		22,077	9,317	4,570	5,464	1,581	177,023
	TOTAL ADJUSTMENTS	1,382,928	64,825	45,319	0	218,541	25,874	171,398	318,192	2,338	2,229,415
	COST ACCEPTED	17,300,412	3,624,355	2,898,965	0	2,828,328	1,125,664	524,692	553,643	189,262	29,045,321
	COST NOT CLAIMED		3,686	299,097							302,783

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
COST CLAIMED PER
FINAL ADMINISTRATIVE COST PROPOSAL
AND RELATED AUDITOR RECOMMENDATIONS
BY OPERATION - PART B
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1988

ADJ. #	EXPLANATION OF ADJUSTMENTS
1.	Represents costs set aside that are related to the cost of goods and services purchased from subsidiaries, net of subsidiary profits.
2.	Represents unallowable interest costs charged to Medicare. These costs are allocated on a pro rata basis based on the FACP personal service costs.
3.	Represents lease payment costs overcharged to Medicare. These costs are allocated by operations based on where the costs were originally charged.
4.	Represents subsidiaries profits charged to Medicare.
5.	Represents the Technical Support area adjustment of residual amounts.
6.	Represents cost of pension expense attributable to the Special Early Retirement Program (SERP).
7.	Represents Return on Investment on parking lot facility. These costs are allocated on a pro rata basis based on the FACP personal service costs.
8.	Represents the Complementary Credit Adjustment. These costs were allocated one-hundred percent to the claims payment operation.
9.	Represents the Building occupancy costs overcharged to Medicare. These costs are allocated on a pro rata basis based on the FACP personal service costs.
10.	Represents legal costs charged to Medicare without documentation. These costs are allocated on a pro rata basis based on the FACP personal service costs.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
COST CLAIMED PER
FINAL ADMINISTRATIVE COST PROPOSAL
AND RELATED AUDITOR RECOMMENDATIONS
BY OPERATION - PART B
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1988

ADJ. #	EXPLANATION OF ADJUSTMENTS
11.	Represents miscellaneous income credits. This adjustment is allocated on a pro rata basis on the FACP personal service costs.
12.	This is the excess amount of costs incurred above costs claimed by the Auditee. The total costs not claimed were amounts expended in excess of the negotiated fixed rate per claim.

APPENDIX

Blue Cross
Blue Shield
of Michigan

Medicare

Rosalee Livingston
Vice President
Government Business Group

600 Lafayette East
Detroit, Michigan 48226

October 23, 1992

Walter D. Davis
President
Davis, Graves & Livingston, P.C.
Suite 340
4500 Bissonnet
Bellaire, Texas 77401

Dear Mr. Davis:

We have completed our review of your draft audit report of our Medicare administrative expenses for fiscal years 1988 and 1989. Of the $3,372,633 that the draft audit report recommends for adjustment, we are in agreement with $2,289,772 of the findings. This includes the $2,135,884 finding on the Special Early Retirement Program (SERP) that was previously agreed to in a separate pension audit.

Enclosed is a summary and finding-by-finding response to the draft audit report. Where there is disagreement, we explain our position and/or the basis for re-calculating the amount of the finding.

If there are any questions on the enclosed material, please contact Lou Gorning, Director of Government Budget & Reporting on (313) 225-7374 or contact Norm Schweiger of the Cost Department on (313) 225-0425.

Sincerely,

Rosalee Livingston

Rosalee Livingston

Enclosure

cc: J. Sucharski, HCFA R.O.
P. Swanson, OIG

DAVIS, GRAVES & LIVINGSTON MEDICARE AUDIT
FISCAL YEARS 1988 THROUGH 1989

NO.	DESCRIPTION	DG&L AUDIT REPORT	BCBSM RESPONSES	COMMENTS
1	Subsidiaries (Profit)	$97,247	$97,247	BCBSM agrees with findings.
2	SERP	2,135,884	2,135,884	BCBSM agrees with findings.
3	Technical Support Areas	52,033	52,033	BCBSM agrees with findings.
4	Interest on Notes Payable	110,648	110,648	BCBSM agrees with findings.
5	Leased Equipment – Disk Storage Equipment	28,750	24,146	BCBSM agrees with finding at a reduced rate.
6	Building Occupancy - Duplicate Utility Cha	32	0	BCBSM disagrees with findings.
7	Complementary Credits	129,425	0	BCBSM disagrees with findings.
8	Accrued Subcontract	65,316	0	BCBSM disagrees with findings.
9	Return on Investment	7,326	7,326	BCBSM agrees with findings.
10	Building Occupancy Distribution	193,616	10,296	BCBSM only partially agrees with findings.
11	Legal Fees	7,551	7,551	BCBSM agrees with findings, but at a lesser rate .
12	Miscellaneous Income Credits	512,795	(155,359)	BCBSM disagrees with findings.
		$3,372,633	$2,289,772	

DAVIS, GRAVES, & LIVINGSTON MEDICARE AUDIT RESPONSES
FISCAL YEAR 1988 & 1989

FINDING #1: SUBSIDIARY PROFITS – $97,247

The DG&L review showed the Auditee had not eliminated all the profits included in the costs allocated to Medicare by the four subsidiaries. However, the Auditee had made a credit adjustment of $84,192 to the FY 1988 FACP and $14,126 to the FY 1989 FACP. The Auditee applied a composite profit margin factor of 4.5% to the subsidiaries costs recorded in account 745.03 that were charged to the Medicare line of business.

DG&L calculated the amount of profits charged to Medicare by applying the profit margin factor used by the Auditee, to the total billings from each subsidiary to Blue Cross and Blue Shield of Michigan.

RESPONSE:
BCBSM agrees with the finding.

FINDING #2: SPECIAL EARLY RETIREMENT PROGRAM (PENSION EXPENSE) – $2,135,884

Auditee amended its pension plans in Fiscal Year 1988 with a Special Early Retirement Program (SERP) for Fiscal Year 1988. The auditee allocated approximately $3 million of SERP expense to Medicare and claimed the expense on its 1988 Final Administrative Cost Proposal (FACP). Auditee was reimbursed $2,135,884 of the claimed SERP pension expense.

As a result of a special audit performed by the Office of Inspector General, of Special Early Retirement Program Pension Cost claimed by Auditee, the entire amount reimbursed by Medicare was disallowed. Their report dated June 4, 1992.

We recommend that the auditee make the appropriate financial adjustments.

RESPONSE:
BCBSM agrees with the finding.

FINDING #3: TECHNICAL SUPPORT AREAS – $52,033

Technical support cost centers were billed to users, including Medicare, at rates less than actual cost of certain cost centers. The resulting residual amounts in these cost centers were then distributed to the user. Prior to October 1988 residual amounts were distributed to the users on a different cost allocation basis, resulting in overcharges to Medicare. In October 1988, the basis for distributing residual amounts was changed to the same basis used to bill users. As a result of this change a retroactive adjustment was made to the Final Administrative Cost Proposal for Fiscal Year 1988. However, the adjustment amount for the period October 1, 1987 through December 31, 1987 was not recorded. We are recommending a financial adjustment for the net amount relating to the period totalling $52,033.

RESPONSE:
BCBSM agrees with the finding.

FINDING #4: INTEREST ON NOTES PAYABLE – $110,648
The Auditee overcharged Medicare $110,648 for unallowable interest cost related to installment payments on a promissory note.

In July 1985, the Auditee leased certain equipment from the Finalco Corporation. These leases were subsequently purchased from Finalco by the Signal corporation. In March 1987, the Auditee decided to terminate its lease on some of the equipment from Signal.

Under the terms of the lease agreement for the old equipment, the Auditee was required to pay certain termination costs. To cover the termination costs, the Auditee signed a promissory note with Signal as security. The terms of the note included 36 monthly payments of $61,441 and a principal amount of $2,039,022.

We determined that 98% of notes payments in FY 1988 and FY 1989 were charged to Medicare Part B. We further determined that the notes payments included interest costs which were unallowable under title 48 CFR 31.205–20 totaling $37,745 for FY 1988 and $75,161 for FY 1989.

RESPONSE:
BCBSM agrees with the finding.

FINDING #5: LEASED EQUIPMENT – DISK STORAGE EQUIPMENT – $28,750
Medicare was overcharged for lease payments by $28,750 in FY 1988 by allocating to Medicare lease payments in excess of costs allowable under Title 48 CFR 31.205–2(b)(4).

The Auditee leased certain Automated Data Processing Equipment from a subsidiary. In 1986, Tower Management, a subsidiary of the Auditee, purchased disk storage equipment from International Business Machines. The auditee leased this equipment from Tower Management from September 1986 to August 1988. Subsequently, the auditee purchased the equipment from the subsidiary in September 1988.

RESPONSE:
BCBSM agrees with the finding at a reduced amount of $24,146.
The Federal Aquisition Regulations state that lease payments to a subsidiary cannot exceed the cost of ownership of the assets in question. A review was conducted of the auditors calculations for ownership costs, which include depreciation and ROI, and total lease payments made during Fiscal Year 1988. The calculations were found to be correct.

However, a review of the calculations for Finding #1 shows that Tower Management invoices relating to the above lease payments were also included in the Subsidiary Profits Finding. Therefore, in the calculations for Finding #5, the total lease payments made to Tower Management must be reduced by 4.5% before comparing total lease charges to ownership costs. The 4.5% factor is the amount of profit deducted from subsidiary billings in Finding #1.

We have recalculated the excess lease payments charged to Medicare in Fiscal Year 1988 to be $12,111 for Part A and $12,035 for Part B.

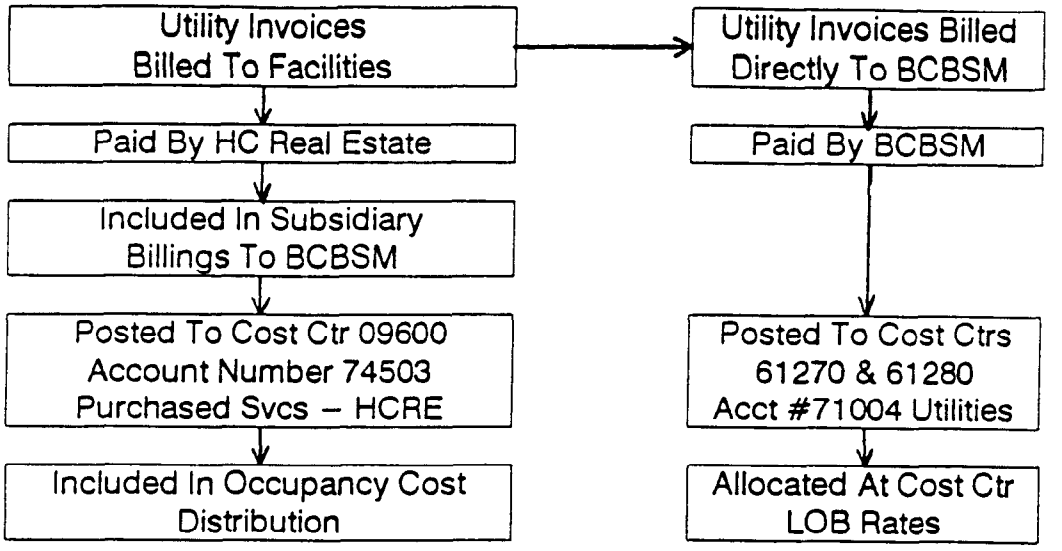
Total Lease Payments		$1,184,293	
Less Profit Margin (4.5%)		53,293	
		1,131,000	
Less Ownership Costs		851,501	
Total Excess Payments		279,499	
	Part A		Part B
	4.333%		4.306%
Allocated Excess Lease Payments	$12,111		$12,035
Total Part A & B		$24,146	

FINDING #6: BUILDING OCCUPANCY – DUPLICATE UTILITY CHARGE – $32,042
Medicare was overcharged $32,042 in utility costs in FY 1989. Auditee used a standard square footage rate to distribute occupancy cost to each cost center. Occupancy cost was computed for the month by multiplying the net usable space by the standard foot rate. The standard rate charge included the cost of rent, depreciation, security, and utilites.

We determined that during the months of October, November and December 1988, utility costs totaling $32,042 were allocated to Medicare in addition to the regular occupancy costs allocation.

We questioned the additional utility costs allocated to Medicare since utility costs were already included in the computations of standard rates used in the allocations of occupancy costs.

RESPONSE:
BCBSM disagrees with this finding.
Through Calendar Year 1988, BCBSM's occupancy cost distribution system called for all building services charges to be paid by HC Real Estate, a property management subsidiary of BCBSM. The building services costs, which included utility charges, were then billed to BCBSM by HC Real Estate. When the invoices were paid, the expenses were booked to cost center 09600, a control account. The total expenditures for 09600 were then used to develop a standard square footage rate to charge back occupancy costs to the various cost centers in each facility. However, during the period October – December 1988, utility invoices were routed directly to BCBSM for payment, bypassing HC Real Estate (See the flow chart on page 4). BCBSM then paid the utility invoices booking the expense to cost centers 61270, Outstate Facility Operations, and 61280, Diversitec Operations. These expenses were then allocated to customers, including Medicare, based on each cost center's allocation rate. Since the only cost center used to compute the occupancy cost distribution was 09600, the utility invoices charged to cost centers 61270 and 61280 were not added into the allocation base and therefore not double charged to Medicare.



FINDING #7: COMPLEMENTARY CREDITS – $129,425

DG&L's review of the complementary credit computation disclosed discrepancies between the amount reported in the Final Administration Cost Proposal (FACP), and information given to us by the Auditee.

Based on our discussion with the Auditee's staff, we were told the amounts reported in the FACP did not represent complementary credits actually allocated to Medicare but were estimates.

RESPONSE:

BCBSM disagrees with the finding.

DG&L obtained their amounts from the HCFA Form 1523B and 1524B (Schedule of Credits EDP and Overhead), a supplementary information schedule attached to the IER and FACP cost reports. The data on this form does not come directly from the allocations and is required to be computed separately. BCBSM agrees that the Complimentary Credit amounts shown on the 1523B and the 1524B were lower than the actual allocations of Complementary Credits on the FACP. However, BCBSM'S actual reporting of cost and credits to HCFA/Medicare are properly reflected on the FACP itself.

FINDING #8: ACCRUED SUBCONTRACT – $65,316

Auditee accrued and charged to Medicare in FY 1989 subcontract expense for auditing services expected to be performed in the subsequent fiscal year. Although it appears that the Department of Health and Human Services allows for the accrual of such cost, generally accepted accounting principles require that expenses be recorded in the accounting period that the actual obligation is incurred.

We determined that the amount of accrued subcontract expense that is not in accordance with generally accepted accounting principles was charged to Medicare in FY 1989, for $65,316.

RESPONSE:
BCBSM disagrees with the finding, but agrees on the accounting principle of GAAP.
HCFA has instructed contractors to subcontract in FY 1989 to maximum extent possible, "even if the work is not completed until September 30, 1990, at the latest". The cost reports which were to be audited by subcontractors needed to be in the Fiscal Intermediaries possession by September 30, 1989, in order for the subcontract to qualify for obligation in Fiscal Year 1989. The requirements are detailed in HCFA's letter of August 1989, copy attached. Copies of invoices supporting the accrual are available for review. BCBSM believes this authorization allows a Plan to claim the expense.

FINDING #9: RETURN ON INVESTMENT – $7,326
The auditee allocated $3,323 in FY 1988 and $4,003 in FY 1989 to Medicare for Return on Investment on an unallowable asset.

Return on Investment (ROI) costs were charged to Medicare for a parking lot facility that was no longer an asset of the Auditee.

RESPONSE:
BCBSM agrees with the finding.

FINDING #10: BUILDING OCCUPANCY DISTRIBUTION – $193,616
BCBSM overcharged Medicare by $193,616 in FY's 1988 and 1989 for building occupancy costs.

Generally, occupancy cost is distributed based on a standard rate per square foot. At the end of the calendar year when the actual cost is determined, BCBSM then prepares an analysis of actual costs versus distributed costs. The amount of over/under distributed occupancy costs are computed and adjustments are then made to bring the distributed costs in line with actual costs.

The DG&L review revealed that in FY's 1988 and 1989, BCBSM did not adjust the occupancy costs that were based on a standard rate to bring it in line with actual costs. DG&L recalculated the occupancy costs applicable to Medicare and determined that Medicare was overcharged by $193,616.

RESPONSE:
BCBSM disagrees with the finding.
BCBSM agrees with the auditors that if Fiscal Years 1988 and 1989 are isolated and the occupancy charges calculated, this finding would be correct. However, the credit for over allocating occupancy charges during this period was made in December of 1989 which would translate into Fiscal Year 1990.

The process BCBSM uses to distribute occupancy charges is split into three basic steps.

1. Occupancy charge distributions are calculated based on a standard square foot rate. This distribution rate is based on the budgeted cost for the Building Services cost centers and the usable square footage of space.

2. When actual costs for each month become available, the distribution is recalculated and compared to the cost distributed based on budgeted figures. The resulting over or under allocation is monitored on the variance analysis report on a year to date basis.

3. When the over or under allocation variance becomes material, an adjustment is made to bring the actual allocations in line with what should be allocated based on actual costs. This adjustment usually happens on an annual basis in December, but it could happen anytime throughout the year.

Depending on when the adjustments are made during the year, there most likely will be an over or under allocation in one fiscal year, with the opposite happening in the subsequent fiscal year. The year end adjustments for Calendar Years 1988 and 1989, were not made until December of 1989. Therefore, when Fiscal Years 1988 and 1989 are isolated, there is an overcharge to Medicare. However, during Fiscal Year 1990, there is an undercharge to Medicare which offsets the previous fiscal year variance.

Following is a breakdown of the periodic over and under allocations of occupancy charges:

	Total over\(under)	CY over\(under)	FY over\(under)
Jan – Sept 1987	($541,422)		
Oct – Dec 1987	(506,769)	(1,048,191)	
Jan – Sept 1988	1,500,372		993,603
Oct – Dec 1988	380,881	1,881,253	
Jan – Sept 1989	210,093		590,974
Oct – Dec 1989	(2,105,989)	(1,895,896)	
Jan – Sept 1990	611,095		(1,494,894)
Oct – Dec 1990	51,725	662,820	
	($400,014)	($400,014)	$89,683

The total overcharge across Fiscal Years 1988, 89, & 90 is $89,683. The allocated portion charged to Medicare is as follows:

Part A:	2.96%	$2,655
Part B:	8.52%	$7,641
Total		$10,296

Although there was a slight net overcharge of occupancy costs through Fiscal Year 1990, this variance should be virtually eliminated during Fiscal Year 1991.

FINDING #11: LEGAL FEES – $7,551

DG&L questioned the legal fees charged to Medicare in the amount of $7,551 for FY's 1988 and 1989.

The amounts were paid to the law firm of Bodman & Longley for the defense of the Auditee for pending litigation brought by the Federal Government involving the Medicare Secondary Payer laws. The Health Care Financing Administration is also actively involved in the prosecution of the civil litigation.

We were not allowed to review the documentation supporting the payments or the circumstances surrounding the litigation because the case was pending.

RESPONSE:

BCBSM agrees with the finding, but at a lesser amount of $6,860.66.
According to Federal Aquisition Regulation 31.205–47(b), costs incurred in connection with the defense of charges brought by the Government against a contractor are unallowable for reimbursement. Therefore, we agree with the above finding to the extent of the Federal Reimbursement Policy. However, the amount calculated by BCBSM is slightly different than that of the auditors because incorrect LOB rates were used. The following is BCBSM's calculation of unallowable legal expense charged to Medicare for Fiscal Years 1988 and 1989:

	FY 88	FY 89	Total
Part A	$145.68	$2,225.44	$2,371.12
Part B	97.12	4,392.42	4,489.54
	$242.80	$6,617.86	$6,860.66

FINDING #12 – MISCELLANEOUS INCOME CREDITS

Auditee failed to credit to Medicare income received for certain services provided to the auditee's subsidiaries and others. We determined that a total amount of $512,795 should have been credited to Medicare during FY's 1988 and 1989.

We also noted and identified income amounts that were not related to Medicare; and computed the credits due to Medicare.

RESPONSE:

BCBSM disagrees with the findings.
BCBSM receives reimbursement for certain expenses from outside sources. These "recoveries" are then credited to BCBSM's various customers based on the allocation of the original expense. The Miscellaneous Income accounts 49240, Advance Seminar Fees, and 49250, Miscellaneous Admin. Exp. Reimb., are used to record the receipt of these reimbursements and, in turn, form the allocation base used to credit revenue to the various customers. In order to equitably distribute this miscellaneous revenue, BCBSM classifies the recoveries into three categories. These are: Medicare only; Medicare and private business; private business only. Exhibit A identifies these three categories. Note that Medicare only recoveries are credited 100% to Medicare, private business only recoveries are credited 100% to private business, and

reimbursements for expenses incurred by both Medicare and private business are credited to customers based on the allocation of the initial expense.

As mentioned above, the only Miscellaneous Income accounts which should be allocated back to the various customers are 49240, Advanced Seminar Fees, and 49250, Misc. Admin. Exp. Reimb. DG&L included in the allocation base account #49110, Parking Facility. The expense incurred to maintain the parking facility is included in an administrative expense account which is allocated 100% to private business. Therefore, the revenue included in account #49110 which offsets this parking facility expense, should not be allocated to Medicare. Revenue in Account #49110 is generated from employee payroll deductions.

In addition, for Fiscal Year 1989 DG&L used revenue charged to a sub account entitled Diversitec as allocable to Medicare and private business. Electronic Media Claims revenue (EMC) included in this subaccount amounts to $3,041,863 and is credited to Medicare and private business. However, the remaining $2,845,168 represents revenues received by Diversitec prior to the closing of the subsidiary, and the amount moved to the parent company's books in 1989. This portion was not allocated to any customers.

BCBSM agrees, as previously stated in the documentation supplied to the auditor, that a credit was not given in Fiscal Year 1988. BCBSM, however, disagrees with the auditors interpretation of the substance of each sub account and DG&L's calculation.

BCBSM claims that the finding should be as follows, rather than that reported in the auditor's findings.

	PART A	PART B	TOTAL
FISCAL YEAR 1988:			
Claimed	$0	$0	$0
Owed	49,445	177,023	226,468
Total Owed HCFA	$49,445	$177,023	$226,468
DG&L Finding	140,681	290,924	431,605
Difference	($91,236)	($113,901)	($205,137)
FISCAL YEAR 1989:			
Claimed	$152,830	$340,302	$493,132
Owed	21,914	89,391	111,305
Total Owed BCBSM	($130,916)	($250,911)	($381,827)
DG&L Finding	25,162	56,028	81,190
Difference	($156,078)	($306,939)	($463,017)
TOTAL F.Y.'88 & 89:			
Total Owed BCBSM	($81,471)	($73,888)	($155,359)
Total DG&L Finding	165,843	346,952	512,795
Difference	$247,314	$420,840	$668,154

OTHER MATTERS – CHANGES IN ADMINISTRATIVE COSTS

DG&L requires comments on the following significant variances between Fiscal Years 1987 and 1988, and 1988 and 1989.

	NOTE	1989	1988	Inc/(Dec)
Part A				
Provider Desk Review	(1)	1,270,978	1,512,833	(241,855)
Provider Reimbursements	(1)	948,178	1,209,588	(261,410)
Part B				
Reviews and Hearings	(2)	3,615,141	4,000,640	(385,499)

		1988	1987	Inc/(Dec)
Part A				
Provider Field Audit	(3)	2,326,510	2,017,585	308,925
Provider Settlement	(3)	1,214,035	852,506	361,529
Provider Reimbursements	(3)	1,209,588	1,082,995	126,593
Other – RIT Backlog	(4)	136,456	195,636	(59,180)
Other – Pro Bill	(4)	300890	61998	238,892

Expenses increased/decreased for the following reasons:

(1) PROVIDER DESK REVIEWS – SERP expenses were charged in 1988; the number of desk reviews decreased by 259; HHA and Home Office decreases.

(1) PROVIDER REIMBURSEMENTS – SERP expenses were charged in 1988; the number of reimbursements decreased by 22; no more freestanding HHA's; fewer providers on PIP (Periodic Interim Payment).

(2) REVIEWS AND HEARINGS – For two months at the beginning of FY 1988, our clerical workforce was on strike and this function was performed by salaried staff which was more expensive to do so. FY 1989 was a normal period and costs were reduced accordingly. The workload appears to increase between the fiscal periods but there was a change in counting items from cases in FY 1988 to claims in FY 1989 which distorts the comparision of workloads.

(3) PROVIDER FIELD AUDIT – SERP expense charged;

(3) PROVIDER SETTLEMENT – SERP expense charged; PPS settlement and reopening increases; malpractice settlement reopening increases; HHA reopening increases; hospital/other reopening increases.

(3) PROVIDER REIMBURSEMENTS – SERP expense charged.

(4) OTHER – RTI BACKLOG & PRO BILL ADJUSTMENTS – There was a backlog of PRO bill adjustments that was cleared in FY 1988. In order to do the PRO adjustments, personnel were shifted from Return to Intermediary (RTIs) adjustments. The following year HCFA was concerned about the build up of RTIs and personnel were shifted back to RTIs.

DEPARTMENT OF HEALTH & HUMAN SERVICES

Health Care Financing Administration

Memorandum

Date AUG -1 1989

Refer to: BPO-F11

From Director
Office of Financial Operations

Subject Authorization for Subcontractors-FY 89--ACTION

To ARAs for Financial Operations
Regions V, VI, X
ARAs for Medicare
Regions I, II, III, IV, VII, VIII, IX

This supplements our memorandum of June 26, 1989 to all Associate Regional Administrators (tab A) requesting estimates of additional funding for audit subcontract work in FY 89.

We have attached copies of an August 12, 1987 memo from Health and Human Services (HHS), Office of Financial Policy (tab B) and the October 6, 1988 memo from HHS, Division of Acquisition Policy (tab C) which clarify Section 210 of the Appropriation Act.

Section 210 permits funds provided in this Act to be used for 1-year contracts which are to be performed in 2 fiscal years, so long as the total amount for such contracts is obligated in the year for which the funds are appropriated. This should be considered in your current discussions with contractors since this will supersede the 120-day limitation imposed for completing subcontract work in our memorandum of June 26, 1989 . As stated in discussions with your staff, contractors should be advised to provide their regional office with estimates of unfinished workload for FY 89 and the costs for subcontracts to be obligated in FY 89 but not completed until FY 90. Upon receiving these estimates from each regional office, an analysis of funds will be used to provide the regions with additional funding in FY 89 for the obligations due to new subcontracts.

To administer this directive the regional offices should be cognizant of the following:

1) Fiscal intermediaries (FIs) requesting additional funding must exhaust all FY 89 current audit allotments.

2) FIs do not need a Request for Proposal to subcontract. FIs can use a streamlined process to subcontract the FY 89 audit work (tab D).

3) FIs can request additional funding to subcontract the audit of hospital credit balances.

Please submit no later than August 4, 1989 for each contractor within your region, the nature and dollar amounts of estimated subcontracts for FY 89 to be completed in FY 90 to:

Health Care Financing Administration
Bureau of Program Operations
Office of Financial Operations
Director, Division of Provider Audit
6300 Security Boulevard
Room 1445, Meadows East Building
P.O. Box 26679
Baltimore, Maryland 21207

Also, in order for the funds to be obligated in FY 89, all Notice of Budget Approvals for subcontract obligations must be received in this office no later than September 20, 1989.

In addition, this office is negotiating the Contractor Performance Evaluation Program (CPEP) standards which could be affected by this directive with the Office of Program Administration. If modifications to the CPEP standards are warranted, a separate statement will be issued.

Please contact the audit analyst assigned to your region with any questions on this issue.

Authorization for subcontractors:		
Regions I, II, V	David Walker	FTS, 646-7556
Regions III, IV	Wayne Schreiber	FTS, 646-7549
Regions VI, VIII	Sara F. Smalley	FTS, 646-7551
Regions VII, IX, X	William Heffner	FTS, 646-7557
Hospital Credit Balances		
All Regions	Stan Herbst	FTS, 646-0536
	John Epple	FTS, 646-7562

Charles J. Schreiber

Attachments - 4

cc:
Frank Derville