October 21, 2009

Report Number: A-07-08-04137

Ms. Beryl Lowery-Born  
Vice President of Finance and Chief Financial Officer  
Blue Cross Blue Shield of Kansas  
1133 SW. Topeka Boulevard  
Topeka, Kansas  66629-0001

Dear Ms. Lowery-Born:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled “Review of Wheatlands Administrative Services, Inc.’s Final Administrative Cost Proposals for Fiscal Years 2005 Through 2008.” We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.


If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or contact Debra Keasling, Audit Manager, at (816) 426-3213 or through email at Debra.Keasling@oig.hhs.gov. Please refer to report number A-07-08-04137 in all correspondence.

Sincerely,

/ Patrick J. Cogley/
Regional Inspector General  
for Audit Services

Enclosure
Direct Reply to HHS Action Official:

Ms. Deborah Taylor, Acting Director
Office of Financial Management
Centers for Medicare & Medicaid Services
Mail Stop C3-01-24
7500 Security Boulevard
Baltimore, Maryland  21244-1850
Department of Health and Human Services
OFFICE OF
INSPECTOR GENERAL

REVIEW OF WHEATLANDS
ADMINISTRATIVE SERVICES, INC.’S
FINAL ADMINISTRATIVE COST
PROPOSALS FOR FISCAL YEARS 2005
THROUGH 2008

Daniel R. Levinson
Inspector General
October 2009
A-07-08-04137
The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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The Office of Audit Services (OAS) provides auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

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The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support for OIG’s internal operations. OCIG represents OIG in all civil and administrative fraud and abuse cases involving HHS programs, including False Claims Act, program exclusion, and civil monetary penalty cases. In connection with these cases, OCIG also negotiates and monitors corporate integrity agreements. OCIG renders advisory opinions, issues compliance program guidance, publishes fraud alerts, and provides other guidance to the health care industry concerning the anti-kickback statute and other OIG enforcement authorities.
Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
at http://oig.hhs.gov

Section 8L of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site.

OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

BACKGROUND

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled (Medicare) program, which provides for a hospital insurance program (Part A) and a related supplementary medical insurance program (Part B). At the Federal level, the Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contracts with private organizations that process and pay Medicare claims (contractor).

CMS contracts provide for the reimbursement of allowable administrative costs incurred in processing Medicare claims. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and the Medicare contracts. After the close of each fiscal year (FY), contractors submit a Final Administrative Cost Proposal (FACP) reporting Medicare costs. Once CMS accepts an FACP, the contractor and CMS negotiate a final settlement of allowable administrative costs.

CMS contracted with Wheatlands Administrative Services, Inc. (Wheatlands), to serve as a Medicare contractor for processing Medicare Part A and Part B claims. Wheatlands, a wholly owned subsidiary of Blue Cross Blue Shield of Kansas, Inc. (BCBSKS), is located in Topeka, Kansas. Wheatlands processed the Medicare Part A claims for Kansas and the Medicare Part B claims for Kansas, Nebraska, and northwestern Missouri. Wheatlands reported Medicare administrative costs of $111,771,710 in its Part A and Part B FACPs for FYs 2005 through 2008. (This amount included $10,087,572 in pension costs and postretirement benefits that are the subject of a separate review; thus, we reviewed $101,684,138 in costs claimed.) Wheatlands’ Medicare contract ended February 29, 2008.

OBJECTIVE

Our objective was to determine (1) whether the FACPs presented fairly the costs of program administration and (2) whether these costs were reasonable, allowable, and allocable in accordance with part 31 of the FAR and the Medicare contracts.

SUMMARY OF FINDINGS

Wheatlands reported expenditures that substantially complied with the FAR and the Medicare contracts insofar as the costs of program administration were concerned. However, of the $101,684,138 in reviewed costs that Wheatlands claimed for Federal reimbursement in its Part A and Part B FACPs for FYs 2005 through 2008, $416,360 was not allowable or allocable to the Medicare program. Specifically, Wheatlands requested reimbursement in the FACPs for both unsupported costs and unallocable costs.

RECOMMENDATION

We recommend that Wheatlands refund to the Federal Government $416,360 of unallowable costs.
AUDITEE COMMENTS

In written comments on our draft report, BCBSKS did not concur with our first finding regarding unsupported costs, and said that it “is accepting” our second finding concerning unallocable costs. With respect to our second finding, though, BCBSKS stated that $30,959 of the questioned costs had already been adjusted as part of its annual review of executive compensation.

BCBSKS’s written comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing BCBSKS’s written comments, we revised the amount of the questioned costs in our finding and recommendation in this final report to reflect the $30,959 indicated in BCBSKS’s comments. We maintain that our findings and recommendation, as revised, are valid.
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INTRODUCTION

BACKGROUND

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled (Medicare) program, which provides for a hospital insurance program (Part A) and a related supplementary medical insurance program (Part B). At the Federal level, the Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contracts with private organizations that process and pay Medicare claims (contractor).

CMS contracts provide for the reimbursement of allowable administrative costs incurred in processing Medicare claims. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and the Medicare contracts. 1 After the close of each fiscal year (FY), contractors submit a Final Administrative Cost Proposal (FACP) reporting Medicare costs. Once CMS accepts an FACP, the contractor and CMS negotiate a final settlement of allowable administrative costs.


OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine (1) whether the FACPs presented fairly the costs of program administration and (2) whether these costs were reasonable, allowable, and allocable in accordance with part 31 of the FAR and the Medicare contracts.

Scope

Our review covered the period October 1, 2004, through February 29, 2008 (FY 2005 through the termination date of Wheatlands’ Medicare contract in FY 2008). For this period, Wheatlands reported Medicare Part A and Part B costs totaling $111,771,710. This total included pension costs and postretirement benefits of $10,087,572 that are the subject of a separate audit and that we therefore excluded from this review. Thus, we reviewed $101,684,138 of administrative costs.

1The development of the FAR system is in accordance with the requirements of the Office of Federal Procurement Policy Act of 1974 (P.L. No. 93-400, as amended by P.L. No. 96-83).
We did not review the overall internal control structure at Wheatlands because our objective did not require us to do so. However, we reviewed the internal controls that Wheatlands had in place to allocate costs to cost objectives in accordance with the FAR and the Medicare contracts.

We conducted fieldwork at Wheatlands’ office in Topeka, Kansas, from September 2008 through February 2009.

METHODOLOGY

To accomplish our objective, we:

- reviewed applicable Medicare laws, regulations, and guidelines; the applicable sections of the FAR; and Wheatlands’ contract with CMS;
- reviewed calendar years 2005 through 2007 independent auditor’s reports;
- reconciled the FACPs to Wheatlands’ accounting records;
- judgmentally selected and reviewed invoices, expense vouchers and reports, and journal entries;
- interviewed Wheatlands officials about their cost accumulation processes for cost proposals and gained an understanding of Wheatlands’ cost allocation systems;
- reviewed payroll journals, corporate bonus plans, and personnel records;
- tested costs for reasonableness, allowability, and allocability; and
- provided Wheatlands officials with detail data on the unsupported and unallocable costs (discussed below) on May 26, 2009.

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

FINDINGS AND RECOMMENDATION

Wheatlands reported expenditures that substantially complied with the FAR and the Medicare contracts insofar as the costs of program administration were concerned. However, of the $101,684,138 in reviewed costs that Wheatlands claimed for Federal reimbursement in its Part A and Part B FACPs for FYs 2005 through 2008, $416,360 was not allowable or allocable to the Medicare program. Specifically, Wheatlands requested reimbursement in the FACPs for both unsupported costs and unallocable costs.
UNSUPPORTED COSTS

Federal Requirements

Pursuant to FAR 31.201-2(d):

A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported.

Salaries and Wages

Wheatlands reported $14,220,051 for the salaries and wages cost category in its FY 2007 Part B FACP. However, Wheatlands’ records for FY 2007 supported salaries and wages of only $13,908,219. Thus, for FY 2007 Wheatlands reported $311,832 more in its Part B FACP for salaries and wages than was supported by its records. The $311,832 was unallowable for Federal reimbursement because this amount was not supported by documentation as mandated by FAR 31.201-2(d). See Appendix A.

UNALLOCABLE COSTS

Federal Requirements

Pursuant to FAR 31.201-4:

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it—

(a) Is incurred specifically for the contract;

(b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or

(c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

Long-Term Incentives

According to BCBSKS officials, the BCBSKS Long-Term Incentive (LTI) plan provided an opportunity for aligning BCBSKS Board of Directors-approved corporate performance goals with a payout opportunity for the achievement of those goals. Further, according to BCBSKS officials, this program motivated participants (that is, BCBSKS executives) to create long-term
value for BCBSKS and its constituents, to measure elements of value creation that participants could impact, and to provide a compensation vehicle to support BCBSKS’s recruitment and retention efforts.

Accordingly, the LTI plan was a performance plan through which BCBSKS paid cash awards for the achievement of company performance goals over a 3-year period. At the beginning of each 3-year performance period, the BCBSKS Board of Directors approved performance goals as well as the threshold, target, and maximum levels for each performance goal. New 3-year performance plans began each year, establishing an overlapping or rolling cycle for performance measurement and payouts. For example, a 3-year cycle beginning in 2005 ended on December 31, 2007, and BCBSKS paid cash awards in 2008; the next cycle began in 2006, ended on December 31, 2008, and BCBSKS paid cash awards in 2009; etc.

We determined that the goals of the LTI plan benefitted BCBSKS, but this performance plan did not benefit Wheatlands and therefore was not allocable to the Medicare contract. For FYs 2005 through 2007, BCBSKS allocated $104,528 ($19,782 in Medicare Part A funds and $84,746 in Medicare Part B funds; see Appendix A) to the Medicare contract for the LTI plan. (These amounts reflect the fact that BCBSKS adjusted the LTI for $30,959 based on its annual review of executive compensation.) These costs were not allocable to Medicare and were therefore not allowable for Federal reimbursement because the costs were not incurred specifically for the Medicare contract, did not benefit the Medicare contract, and were not necessary to the overall operation of Wheatlands in its processing of Medicare Part A and Part B claims.

There were several other incentive and bonus programs to reward executives and employees for achieving various goals.

**RECOMMENDATION**

We recommend that Wheatlands refund to the Federal Government $416,360 of unallowable costs.

**AUDITEE COMMENTS**

In written comments on our draft report, BCBSKS did not concur with our first finding regarding unsupported costs, and said that it “is accepting” our second finding concerning unallocable costs.

With respect to our first finding, BCBSKS stated that:

> After reviewing the OIG [Office of Inspector General] prepared reconciliation, BCBSKS determined that the Salaries and Wages related to Overhead and G&A [General and Administrative] [costs] incurred after December 2006 reported on the Cost Classification section of the FACP were not included in the OIG totals for Salaries and Wages. This is why it appears these costs are overstated for the OIG FACP workpapers.
With respect to our second finding, BCBSKS stated:

BCBSKS management made the decision to remove LTI from Medicare allocations beginning in January 2007. Therefore, BCBSKS is accepting this finding to be consistent with its own subsequent decision. However, $30,959 of this LTI had already been adjusted as part of the annual review of executive compensation. . . . Based on this adjustment, BCBSKS agrees that $104,528 should be decreased from the total expenses claimed on the FACPs for FY05-FY08.

BCBSKS’s written comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing BCBSKS’s written comments, we revised the amount of the questioned costs in our finding and recommendation in this final report to reflect the $30,959 indicated in BCBSKS’s comments. We maintain that our findings and recommendation, as revised, are valid.

With respect to BCBSKS’s more specific comments:

In developing our first finding regarding unsupported costs, we included Overhead and General and Administrative costs incurred for FY 2007. The requested detail information that BCBSKS provided to us did not separately and distinctly identify costs representing salaries and wages delineated by FY or by Medicare Part A or Medicare Part B costs. Thus, we were not able to separately identify Overhead and General and Administrative costs. Because BCBSKS provided us with only combined costs rather than separately identified costs, it did not adequately support its claimed costs and, for that reason, was not fulfilling the requirement placed upon it by FAR 31.201-2(d), which states: “The contracting officer may disallow all or part of a claimed cost that is inadequately supported.” Therefore, we continue to recommend that BCBSKS refund the $311,832 in unsupported costs to CMS.

After reviewing BCBSKS’s written comments concerning our second finding, we agree with BCBSKS and for this final report have revised our finding and recommendation to account for the $30,959 already adjusted by BCBSKS.
APPENDIXES
APPENDIX A – UNSUPPORTED COSTS AND UNALLOCABLE COSTS

UNSUPPORTED COSTS
Salaries and Wages

<table>
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<th>Medicare Part B</th>
<th>Total</th>
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<tr>
<td>2007</td>
<td>$311,832</td>
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<td>$311,832</td>
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UNALLOCABLE COSTS
Long-Term Incentives

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<th>Medicare Part A</th>
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<td>2005</td>
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<td>2,350</td>
<td>8,571</td>
<td>10,921</td>
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<tr>
<td>Total</td>
<td>$19,782</td>
<td>$84,746</td>
<td>$104,528</td>
</tr>
</tbody>
</table>

1There will be a variance due to rounding.
APPENDIX B: AUDITEE COMMENTS

July 31, 2009

Mr. Patrick Cogley
Office of Inspector General
Offices of Audit Services
Region VII – Room 284A
601 East 12th Street
Kansas City, MO 64106

Dear Mr. Cogley,

This letter sets out the revised response of Blue Cross and Blue Shield of Kansas (BCBSKS) to the July 2, 2009 draft of the U.S. Department of Health and Human Services, Office of Inspector General (OIG) draft report A-07-08-04177 entitled "Review of Wheatlands Administrative Services, Inc.'s Final Administrative Cost Proposals for Fiscal Years 2005 Through 2008."

Comments regarding each finding are as follows:

1) Unsupported Costs – Salaries and Wages: Blue Cross and Blue Shield of Kansas does not concur with this finding. OIG claims that Blue Cross reported $311,832 of Salaries & Wages that are unsupported and unallowable. Blue Cross disagrees with this finding. BCBSKS provided OIG with a reconciliation of total costs per the General Ledger compared to the costs reported on the FACPs for all fiscal years being audited, including FY07 for Medicare Part B. After reviewing the OIG prepared reconciliation, BCBSKS determined that the Salaries and Wages related to Overhead and G&A incurred after December 2006 reported on the Cost Classification section of the FACPs were not included in the OIG totals for Salaries and Wages. This is why it appears these costs are overstated for the OIG FACP workpapers.

2) Unallocable Costs – Long Term Incentives: The Long Term Incentive (LTI) finding is attributable to incentives allocated from January 2005 through December 2006. BCBSKS management made the decision to remove LTI from Medicare allocations beginning in January 2007. Therefore, BCBSKS is accepting this finding to be consistent with its own subsequent decision. However, $30,959 of this LTI had already been adjusted as part of the annual review of executive compensation. Annually, total compensation for executives is reviewed in order to ensure that BCBSKS has not charged more compensation than is allowable based on CMS guidelines. Based on this adjustment, BCBSKS agrees that $104,528 should be decreased from the total expenses claimed on the FACPs for FY05-FY08.

We are available at your request for further discussion and review to resolve these findings.

Respectfully,

Beryl Lowery-Born
Vice President of Finance and Chief Financial Officer

*An Independent Licensee of the Blue Cross and Blue Shield Association.*