

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**WISCONSIN PHYSICIANS SERVICE
INSURANCE CORPORATION
CLAIMED UNALLOWABLE MEDICARE
PART B ADMINISTRATIVE COSTS
FOR FYS 2009, 2010, AND 2011**

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for Audit Services

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Office of Inspector General

<http://oig.hhs.gov>

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operating divisions will make final determination on these matters.

Wisconsin Physicians Service Insurance Corporation claimed \$4.8 million in unallowable Medicare Part B administrative costs for Federal FYs 2009, 2010, and 2011.

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) contracted with Wisconsin Physicians Service Insurance Corporation (WPS) to process Part B claims as a carrier under Medicare Contract HCFA 87-032-2 (Medicare contract). CMS requested that we audit WPS's Medicare Part B final administrative cost proposals (FACPs) for Federal fiscal years (FYs) 2009, 2010, and 2011.

The objective of this review was to determine whether the administrative costs WPS claimed on its FACPs for FYs 2009, 2010, and 2011 were allowable in accordance with its Medicare contract and applicable Federal regulations.

BACKGROUND

Title XVIII of the Social Security Act established the Medicare program. CMS administers the Medicare program through contractors, including Part B carriers that process and pay Medicare claims submitted by health care providers. Contracts between CMS and the Medicare contractors define the functions performed by the contractors and provide for the reimbursement of allowable administrative costs incurred in the processing of Medicare claims.

Following the close of each FY, contractors submit to CMS a FACP that reports the Medicare administrative costs incurred during the year. The FACP and supporting data provide the basis for the CMS contracting officer and contractor to negotiate a final settlement of allowable administrative costs. When claiming costs, Medicare contractors must follow cost reimbursement principles contained in part 31 of the Federal Acquisition Regulations (FAR) and other applicable criteria.

During FYs 2009, 2010, and 2011, WPS processed Part B claims as a carrier for Illinois, Michigan, Minnesota, and Wisconsin under its Medicare Part B contract. WPS reported Medicare Part B administrative costs totaling \$115,123,391 in its FYs 2009 through 2011 FACPs.

WHAT WE FOUND

Administrative costs claimed by WPS on its FYs 2009, 2010, and 2011 FACPs were generally reasonable, allowable, and allocable and in compliance with its Medicare contract and other applicable Federal regulations. WPS claimed \$115,123,391 in Medicare Part B administrative costs for FYs 2009 through 2011, including \$3,144,284 in pension costs that were not reviewed. These pension costs will be the subject of a separate review. Of the \$111,979,107 reviewed, we accepted \$107,201,086 as allowable, allocable, and reasonable and questioned the remaining \$4,778,021 as unallowable costs.

WHAT WE RECOMMEND

We recommend that WPS:

- reduce its FACP for FYs 2009, 2010, and 2011 by \$4,778,021 to eliminate the unallowable costs identified in this report; and
- improve procedures to:
 - identify allowable and unallowable costs in accordance with applicable contract and FAR provisions;
 - ensure that when an unallowable cost is incurred, its directly associated costs are properly identified and excluded;
 - assure that revenue, payroll, and net-book-value of assets percentages used in developing three-factor formula rates are consistent with guidance defined in the Cost Accounting Standards and the FAR provisions defining reasonableness;
 - maintain complete accounting detail to support Medicare costs claimed including detailed support of: residual home office expense pools and subsequent allocations to WPS's Medicare business segment and Medicare contracts, unusual transactions, timing adjustments, or error corrections; and
 - maintain all necessary accounting evidence to assure that the costs claimed on the FACP are adequately supported.

WISCONSIN PHYSICIANS SERVICE INSURANCE CORPORATION COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, WPS did not concur with the majority of our findings related to our recommendation to reduce its FACP by \$4,778,021. WPS did not concur with \$4,699,922 in recommended reductions related to unallowable residual home office (RHO) expenses, EIP bonuses and FICA taxes, salary allocations, and a FACP adjustment. WPS concurs with the \$78,099 in recommended FACP reductions related to unallowable lobbying salaries, auto leases, membership dues and donations, forward funding, and meals. Also, WPS provided limited comments to our recommendation for several procedural improvements. We maintain that all our findings and recommendations are valid.

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INTRODUCTION

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) contracted with Wisconsin Physicians Service Insurance Corporation (WPS) to process Part B claims as a carrier¹ under Medicare Contract HCFA 87-032-2 (Medicare contract). CMS requested that we audit WPS's Medicare Part B final administrative cost proposals (FACPs) for Federal fiscal years (FYs) 2009, 2010, and 2011.

OBJECTIVE

The objective of this review was to determine whether the administrative costs WPS claimed on its FACPs for FYs 2009, 2010, and 2011 were allowable under its Medicare contract and applicable Federal regulations.

BACKGROUND

Title XVIII of the Social Security Act established the Medicare program. CMS administers the Medicare program through contractors, including Part B carriers that process and pay Medicare claims submitted by health care providers. Contracts between CMS and the Medicare contractors define the functions to be performed and provide for the reimbursement of allowable administrative costs incurred processing Medicare claims.

Following the close of each FY, contractors submit to CMS a FACP that reports the Medicare administrative costs incurred during the year. The cost proposal and supporting data provide the basis for the CMS contracting officer and contractor to negotiate a final settlement of allowable administrative costs. When claiming costs, Medicare contractors must follow cost reimbursement principles contained in part 31 of the Federal Acquisition Regulations (FAR) and other applicable criteria.

During FYs 2009, 2010, and 2011, WPS processed Part B claims as a carrier for Illinois, Michigan, Minnesota, and Wisconsin under its Medicare Part B contract. WPS reported Medicare Part B administrative costs totaling \$115,123,391 in its FYs 2009 through 2011 FACPs.

¹ Under Section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act (MMA) of 2003. CMS was required to transfer the Medicare Part A and Part B workloads to Medicare administrative contractors within a 6 year period starting in October 2005. Due to delays in the implementation of some of these transitions, CMS authorized WPS to continue operating as a carrier for Illinois, Michigan, Minnesota, and Wisconsin.

HOW WE CONDUCTED THIS REVIEW

We conducted our review by testing 100 judgmentally selected items from 12 cost centers and expanding our review as necessary. In addition, we reviewed the allocation of residual home office (RHO) expenses based on a prior audit finding.² In testing these items and related expenses, we determined whether these claimed costs were reasonable, allowable, allocable, and in compliance with WPS's Medicare contract and applicable Federal regulations. We limited our internal control review to those controls related to the recording and reporting of costs on the cost proposals.

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 objectives.

See Appendix A for details of the audit scope and methodology. Appendix B contains the contract provisions and regulations applied to determine allowable costs. Appendixes C and D outline the FACP's reviewed and the OIG's recommended cost adjustments.

FINDINGS

Administrative costs claimed by WPS on its FYs 2009, 2010, and 2011 FACP's were generally reasonable, allowable, and allocable and in compliance with its Medicare contract and other applicable Federal regulations. WPS claimed \$115,123,391 in Medicare Part B administrative costs for FY 2009 through FY 2011, including \$3,144,284 in pension costs that were not reviewed. These pension costs will be the subject of a separate review. Of the \$111,979,107 reviewed, we accepted \$107,201,086 as allowable, allocable, and reasonable and questioned the remaining \$4,778,021 as unallowable costs, as follows:

<i><u>OIG Cost Adjustments</u></i>	<i><u>Unallowable Cost</u></i>
Residual Home Office Expenses	\$2,570,015
Employee Incentive Program Bonuses	1,819,947
FICA Taxes	135,106
Salary Allocations	153,888
Lobbying Salaries	34,780
Auto Leases	32,275
Dues and Donations	11,345
FACP Adjustments	20,082
Forward Funding	439
Meals	144
Total OIG cost adjustments	<u><u>\$4,778,021</u></u>

² *Audit of Medicare Part B Administrative Costs for the period October 1, 2006, through September 30, 2008 at the Wisconsin Physicians Service Insurance Corporation (A-05-09-00096) issued November 28, 2011.*

The unallowable costs did not comply with applicable regulations including part 31 of the Federal Acquisition Regulations, the Cost Accounting Standards (CAS), WPS's Medicare contract, and CMS's *Medicare Financial Management Manual* (the Manual).

WPS CLAIMED SOME UNALLOWABLE EXPENSES

Residual Home Office Expenses Were Overstated

WPS overstated the allocation of residual home office (RHO) expenses to its Medicare Part B FACPs by \$2,570,015. WPS allocates RHO expenses to its lines of business, including Medicare, using a three-factor formula (3FF) as described in the Cost Accounting Standards (CAS).³ The 3FF is the average of three percentages: revenue, payroll, and net-book-value (NBV) of assets. Each percentage compares specific performance in one business segment, such as Medicare, to the total of all WPS's business segments including subsidiaries. WPS incorrectly calculated percentage factors described in the CAS in developing its 3FF rates for allocating RHO expenses. These errors resulted in its Medicare business segment 3FF rates being significantly overstated for allocating RHO expenses to Medicare, as illustrated in Tables 1, 2, and 3.

Table 1: Overstated FY Medicare 3FF Rates

<u>Description</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>
WPS's Medicare 3FF rate ⁴	45.85%	45.85%	45.61%
OIG's Medicare 3FF rate ⁵	<u>22.10%</u>	<u>22.38%</u>	<u>21.94%</u>
Overstated Medicare 3FF rate	<u>23.75%</u>	<u>23.47%</u>	<u>23.67%</u>

³ Codified in 48 CFR § 9904.403.

⁴ The FY WPS Medicare 3FF rates were calculated by averaging the 12 monthly 3FF rates applied by WPS in preparing its FACPs. The FACPs reported on the Federal fiscal year, October 1 through September 30.

⁵ Our Medicare 3FF rates represent the average of the three percentages stated in the CAS and were calculated using WPS's general ledger account information by Federal fiscal year, October 1 through September 30.

Table 2: Calculation of Overstated Medicare Part B RHO Expenses Claimed

<i>Description</i>	<i>FY 2009</i>	<i>FY 2010</i>	<i>FY 2011</i>	<i>3YR - Totals</i>
RHO adjusted expense pools ⁶	\$9,749,525	\$9,573,925	\$9,177,345	\$28,500,795
Overstated Medicare 3FF rate	23.75%	23.47%	23.67%	
Overstated Medicare RHO expenses	\$2,315,512	\$2,247,000	\$2,172,277	\$6,734,789
Percent allocated to Part B contract ⁷	38.59%	36.49%	39.43%	
Overstated Part B RHO expenses	\$893,556	\$819,930	\$856,529	\$2,570,015

Table 3: Estimated Differences Between WPS and OIG 3FF Medicare Rates

<i>FY</i>	<i>Factor</i>	<i>WPS</i> ⁸	<i>OIG</i> ⁹	<i>Differences</i> ¹⁰
2009	Revenue percentage	87.89%	18.19%	69.70%
	Payroll percentage	36.74%	34.93%	1.81%
	NBV of Assets percentage	12.92%	13.18%	(0.26)%
	Average 3FF Rate	45.85%	22.10%	23.75%
2010	Revenue percentage	87.00%	16.57%	70.43%
	Payroll percentage	36.96%	35.58%	1.38%
	NBV of Assets percentage	13.59%	14.98%	(1.39)%
	Average 3FF Rate	45.85%	22.38%	23.47%
2011	Revenue percentage	82.80%	15.63%	67.17%
	Payroll percentage	36.44%	34.66%	1.78%
	NBV of Assets percentage	17.59%	15.54%	2.05%
	Average 3FF Rate	45.61%	21.94%	23.67%

⁶The adjusted RHO expense pools were developed by the OIG to avoid duplications in determining unallowable costs. The adjusted pools were reduced for 3FF allocated expenses considered unallowable in the OIG's findings for EIP Bonuses, FICA Taxes, Salaries, Auto Leases, Dues and Donations, and Meals.

⁷ Percentages represent how WPS allocated RHO expenses within its Medicare business segment to specific CMS contracts, such as WPS's Medicare Part B contract.

⁸ The WPS FY individual revenue, payroll, and NBV of assets percentages are estimates because WPS calculates these percentages monthly rather than on a FY basis. The average of these estimated individual percentages reconcile to the calculated WPS Medicare 3FF rates.

⁹ Footnote #5 describes how we developed these rates.

¹⁰ Calculated differences represent the approximate overstatement of WPS's Medicare 3FF rates on a FY basis.

Revenue Percentage Factors Were Calculated Incorrectly

WPS incorrectly included billions of dollars in Federal funds received for Medicare benefit claims paid to providers and beneficiaries (claims paid)¹¹ as Medicare operating revenue in developing its Medicare revenue segment percentages. These claims paid are fully reimbursed with Federal funds and do not constitute operating revenue in accordance with the CAS¹² and the Medicare Part B contract.¹³ Also, WPS's treatment of the Medicare benefit claims paid as operating revenue is inconsistent with reported Medicare revenues on its consolidated financial statements¹⁴, and is contrary to the CAS and the Federal regulations concerning allowability and reasonableness (FAR 31.201-2(a) and 31.201-3(b)).

Our analysis properly excluded the billions of dollars in benefit claims paid from Medicare operating revenue totals.¹⁵ Table 3 illustrates that WPS's estimated FY revenue percentages were overstated by 69.70 percentage points for FY 2009, 70.43 percentage points in FY 2010, and 67.16 percentage points in FY 2011. These overstatements increased the 3FF rates and overstated the allocated RHO expenses claimed on the FACPs.

Payroll Percentage Factors Were Calculated Incorrectly

WPS's methodology for developing its Medicare payroll percentages excluded, without sufficient justification, select payroll costs, thereby inappropriately increasing these percentages. The WPS exclusions were:

- Payroll costs allocated to Corporate Expense Cost Center (010060) in 2009 and 2010;
- Capitalized payroll costs related to developing internal use software in 2011; and
- Select staff payroll costs from one subsidiary in 2009, 2010, and 2011.

Excluding these costs is contrary to the CAS and the Federal regulations on determining allowability and reasonableness (FAR 31.201-2(a) and 31.201-3(b)). Our analysis included the

¹¹ Using WPS's methodology of including claims paid, the WPS estimated FY revenue percentages used Medicare operating revenue totals for Federal FYs of \$51.5 billion in FY 2009, \$50.6 billion in FY 2010, and \$39.9 billion in FY 2011.

¹² Codified in 48 CFR § 9904.403-30(a).

¹³ Medicare Part B Contract HCFA 87-032-2, Article II, Paragraph A; Article III, Paragraph A; and Article XV, Paragraph D.

¹⁴ Notes to the consolidated financial statements prepared by Grant Thornton, LLP reported WPS's Medicare revenues for calendar years ended December 31 were \$162.2 million for 2008, \$157.6 million for 2009, \$154.2 million for 2010, and \$153.0 million for 2011. Also, the notes explained that the claims paid under WPS's Medicare administrative service contract are excluded from operations because they are paid, or fully reimbursed, with governmental funds.

¹⁵ The Medicare operating revenue totals excluding claims paid used in the OIG's FY revenue percentages were \$164.2 million in FY 2009, \$151.0 million in FY 2010, and \$151.1 million in FY 2011.

payroll costs that WPS excluded as well as appropriate adjustments for unallowable employee incentive program bonus payments allocated to Medicare and salary costs already allocated by the 3FF. Table 3 illustrates the estimated FY payroll percentage differences between WPS's and our methodologies. WPS's payroll percentages were overstated by 1.81 percentage points for FY 2009, 1.38 percentage points in FY 2010, and 1.78 percentage points in FY 2011. These overstatements increased the 3FF rates and overstated the allocated RHO expenses claimed on the FACPs.

Net-Book-Value of Assets Percentage Factors Were Calculated Improperly

WPS did not follow the CAS in computing the NBV of assets percentage because it used cumulative asset totals. The standards state the NBV shall be the average of the NBV at the beginning of the organization's fiscal year and the NBV at the end of the year (CAS 403-50(c)(1)(iii)). We calculated NBV of asset percentages, based on beginning and ending FYs NBV of assets values, net of assets already allocated by 3FF allocation rates. Table 3 illustrates the estimated FY NBV of assets percentage differences between WPS's and our methodologies resulting in (understatements) of (0.26) percentage points for FYs 2009 and (1.39) percentage points in FY 2010, and an overstatement of 2.05 percentage points in FY 2011. Understatements in these percentages decreased, while overstatements increased, the 3FF rates. RHO expenses claimed on the FACPs were similarly understated for FYs 2009 and 2010, and overstated in FY 2011.

Employee Incentive Program Bonuses and Related FICA Taxes Claimed Were Unallowable

WPS claimed \$1,819,947 in unallowable employee incentive program (EIP) bonuses, and \$135,106 in directly associated unallowable FICA taxes. WPS's EIP bonuses are based on WPS achieving specified corporate-wide profits. The creation of costs on the basis of reaching specified profits contradicts the Medicare Part B contract's intent that WPS be paid under the principle of neither profit nor loss.¹⁶ Claiming costs on FACPs that are dependent on reaching specified corporate-wide profits is inconsistent with the principle that costs are allocable on the basis of relative benefits received or other equitable relationship (FAR 31.201-4).

The FICA taxes related to the unallowable EIP bonuses are unallowable in accordance with regulations which state that costs directly associated with unallowable costs are also unallowable (FAR 31.201-6(a)).

Select Salaries Were Incorrectly Included in the RHO Expense Pools

WPS claimed \$153,888 in inappropriately allocated salaries because select salaries were incorrectly included in the RHO expense pools allocated to Medicare using the 3FF. We identified these salaries by reviewing the one cost center that included the majority of salaries and fringe benefits in the RHO expense pools allocated by the 3FF. Federal regulations specify that costs are allocable if assignable or chargeable on the basis of benefits received or other equitable relationship (FAR 31.201-4). Costs allocated from the RHO expense pools to

¹⁶ Medicare Part B Contract HCFA 87-032-2, Article XV, Paragraph A

Medicare using the 3FF are those that have a beneficial relationship to Medicare but the benefit is not readily quantifiable. The RHO expense pools should exclude:

- costs that have no benefit to the Medicare program and should only be allocated to other business segments such as salaries and fringe benefit costs for WPS's Senior Vice Presidents for Private Claims and Tricare (FAR 31.201-4), and
- costs that benefit only the Medicare program and should be direct expensed to the Medicare business segment such as salaries and fringe costs for WPS's Senior Vice President of Medicare (FAR 31.202).

We determined that select salaries should have been excluded from the RHO expense pools because these costs either provided no benefit to Medicare or should have been directly expensed to Medicare. WPS could not justify including these salaries in the RHO expense pools for allocation to all business segments. Therefore, WPS claimed \$153,888 in inappropriately allocated salaries.

Unallowable Lobbying Salaries Were Claimed

WPS claimed a total of \$34,780 in salaries and benefits directly related to unallowable lobbying costs. Lobbying costs are prohibited under the Medicare Part B contract and Federal regulations (FAR 31.205-22). Further, when an unallowable cost is incurred, directly associated costs are also unallowable (FAR 31.201-6). WPS identified unallowable lobbying salaries based on an estimate of time spent by the employee performing the lobbying activities. We accepted the estimate and determined the unallowable salaries and related fringe benefits.

Personal Use Auto Lease Expenses Were Unallowable Under Federal Regulations

WPS claimed \$32,275 (\$25,482 in FY 2009, \$6,793 in FY 2010) in unallowable auto lease expenses. WPS recognized that expenses allocable to the personal use of leased autos are unallowable under Federal regulations (FAR 31.205-6(m)(2)). Although, WPS identified \$32,275 in unallowable auto lease costs attributed to personal use, its FACPs were not appropriately reduced by \$25,482 in 2009 and \$6,793 in 2010.

Federal Regulations Prohibit Select Dues and Donations

WPS claimed \$11,345 in unallowable membership dues and donations. The contractor claimed \$884 for dues related to unallowable lobbying activities and \$1,769 for a donation to a local organization. Both are considered unallowable under Federal regulations (FAR 31.205-22 and FAR 31.205-8). Additionally, WPS claimed \$8,692 in chamber of commerce dues that exceeded the base dues of the organizations, which provided WPS additional public relations and advertising benefits. These additional payments are unallowable as being neither necessary nor specifically required for the performance of the Medicare contract and expressly unallowable under Federal regulations (FAR 31.205-1).

FACP Adjustments Were Not Adequately Documented

WPS claimed \$20,082 in unsupported FACP cost adjustments. Costs claimed must have supporting documentation, adequate to demonstrate that costs have been incurred, and are allocable to the contract (FAR 31.201-2(d)). WPS was not able to provide adequate supporting documentation to substantiate the adjustments.

Duplicative Forward-Funding Costs Were Incorrectly Claimed

WPS erroneously claimed \$439 in duplicated forward-funding costs on its FY 2009 FACP. These costs had been claimed on the FY 2009 FACP as both regular activity costs and forward-funding costs on the FACP. Accordingly, WPS erroneously reported forward-funding costs on its FY 2009 FACP (CMS's *Medicare Financial Manual* (the Manual), chapter 1, section 90.9M).

Select Meals Were Unallowable

WPS claimed \$144 in unallowable meal expense directly related to an unallowable charity fundraising event. When an unallowable cost is incurred, directly associated costs are also unallowable (FAR 31.201-6).

WPS DOES NOT ROUTINELY MAINTAIN SELECT SUPPORTING DOCUMENTATION

WPS did not routinely maintain necessary documentation to support all: costs claimed on its FACPs; expenses in the RHO expense pools allocated to Medicare by the 3FF; accounting adjustments in developing 3FF rates; and detail for all reporting adjustments. Federal regulations¹⁷ and the Medicare Part B contract¹⁸ require that WPS maintain all necessary accounting evidence to assure the costs claimed are adequately supported. This includes source documentation used at the time the FACP was prepared to certify the validity of the costs it claimed for Medicare reimbursement. This source documentation should reconcile to accounting records and contain adequate detail that explains all adjustments.

Because WPS did not maintain all pertinent support, it had to reconstruct or extract additional documentation from its accounting records in explaining select costs or adjustments. Although WPS was able to provide reconstructed or extracted documentation that reconciled to accounting records, it was difficult and time-consuming to determine if the costs were properly allocated and claimed appropriately. These lapses represent documentation issues that need improvement.

¹⁷ FAR 31.201-2(d) and CMS *Medicare Financial Manual*, chapter 2, section 190

¹⁸ Medicare Part B Contract HCFA 87-032-2, Article XVI, Paragraph K and Article XX, Paragraph A.

PENSION COSTS WERE INCORRECTLY REPORTED

WPS overstated the pension costs reported on the Cost Classification Reports (CCR), Form CMS-2580, submitted with each FACP by \$1,258,817.¹⁹ The CCR requires the contractor to separately identify the pension plan expenses included in the fringe benefits claimed on the FACP. The overstatements resulted from WPS improperly including pension costs allocated to its Medicare Administrative Contract (MAC). We were able to verify that the additional MAC pension costs reported on the CCR were properly excluded from each FACP's fringe benefit totals. Therefore, this incorrect reporting did not affect the costs claimed on the FACPs audited for FYs 2009 through 2011.

RECOMMENDATIONS

We recommend that WPS:

- reduce its FACPs for FYs 2009, 2010, and 2011 by \$4,778,021 to eliminate the unallowable costs identified in this report; and
- improve procedures to:
 - identify allowable and unallowable costs in accordance with applicable contract and FAR provisions;
 - ensure that when an unallowable cost is incurred, its directly associated costs are properly identified and excluded;
 - assure that revenue, payroll, and net-book-value of assets percentages used in developing three-factor formula rates are consistent with guidance defined in the Cost Accounting Standards and the FAR provisions defining reasonableness;
 - maintain complete accounting detail to support Medicare costs claimed including detailed support of: residual home office expense pools and subsequent allocations to WPS's Medicare business segment and Medicare contracts, unusual transactions, timing adjustments, or error corrections; and
 - maintain all necessary accounting evidence to assure that the costs claimed on the FACPs are adequately supported.

WISCONSIN PHYSICIANS SERVICE INSURANCE CORPORATION COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, WPS did not concur with the majority of our findings related to our recommendation to reduce its FACPs by \$4,778,021. WPS did not concur with \$4,699,922 in recommended reductions related to unallowable Residual Home Office (RHO)

¹⁹ The overstated pension costs identified and reported on the CCR were: \$536,594 for FY 2009, \$362,848 for FY 2010, and \$359,375 for FY 2011.

expenses, EIP bonuses and FICA taxes, salary allocations, and an FACP adjustment. WPS concurs with the \$78,099 in recommended FACP reductions related to unallowable lobbying salaries, auto leases, membership dues and donations, forward funding, and meals. Also, WPS provided limited comments to our recommendation for several procedural improvements. We maintain that all our findings and recommendations are valid. WPS's comments are included in their entirety as Appendix E.

OVERSTATED RESIDUAL HOME OFFICE EXPENSES

Applicability of CAS 403

WPS Comments

WPS does not concur that its FACPs should be reduced by \$2,570,015 in overstated RHO expenses. Also, WPS contends it did not overstate the allocation of its RHO expenses to Medicare for any year and the OIG applied the wrong standard because the Medicare contract under which these expenses were claimed is not subject to CAS 403. Instead this contract only requires that WPS's method of allocating indirect costs be "equitable, reasonable, and in accord with the general accepted accounting principles."

Office of Inspector General Response

Beginning in 2007, WPS's home office disclosure statements indicate RHO expenses are allocated using the 3FF, which is a methodology specific to CAS 403. Therefore, these costs are subject to CAS 403. Further, because WPS's 3FF rates are overstated and not compliant with CAS 403 their allocated costs are not equitable, reasonable, nor in accord with generally accepted accounting principles (GAAP).

WPS's RHO Allocation Methodology Endorsed by the Defense Contract Audit Agency

WPS Comments

WPS contends its RHO allocation methodology fully complies with CAS 403 and has been audited and approved by the Defense Contract Audit Agency (DCAA). Also, WPS states the inclusion of Medicare benefits paid in developing its 3FF rates was endorsed by DCAA.

Office of Inspector General Response

WPS's reference to DCAA's prior audit work is not relevant to our findings as we did not rely on DCAA's work in conducting our audit. We stand by our findings which are based on criteria stated in CAS 403, a Financial Accounting Standards Board (FASB) statement, and the Medicare contract which are clear that pass-through monies such as Medicare paid benefits are not operating revenue.

Revenue Percentage Factor

WPS comments

WPS contends that including Medicare benefits paid is compliant with CAS 403 which instructs contractors to allocate costs in proportion to three areas of management concern: (1) the employees of the organization, (2) the business volume, and (3) the capital invested in the organization, and, as such Medicare benefits paid is the best metric of their business volume.

The OIG is erroneous in stating that treating Medicare benefits paid as operating revenue is inconsistent with reported revenue on its consolidated financial statements because, (1) it presents revenue on its financial statements as a “net” figure, (2) in the notes to the statements it explicitly identifies the total claims paid under administrative service only contracts, and (3) it includes Medicare benefits paid within the revenue section of its general ledger.

Office of Inspector General Response

The CAS identifies operating revenue, not business volume, as the basis of the revenue percentage factor of the 3FF. Medicare benefits paid is not a reasonable metric of WPS’s operating revenue as it does not represent the services WPS provides to the Medicare program. WPS processes Medicare claims for which it is paid all the administrative costs associated with processing the provider claims for payment. Unlike WPS’s other insurance segment’s, the funds provided for these claims payments under the Medicare contract are not accrued or charged to customers, clients, or tenants for services rendered and, as such, are not considered operating revenue from which the claims are paid. The amount on the claims for allowable Medicare services that WPS processes are benefit costs in accordance with Article XV, paragraph D of the contract and paid with funds provided in accordance with Article III, paragraph A of the contract.

Therefore, Medicare benefits paid are not considered operating revenue per CAS 403-30(a)(3) or the Medicare contract. Further, a FASB statement²⁰ identifies that revenues are the inflows or other enhancement of assets of an entity or settlement of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations. Medicare benefits paid are not an inflow of an asset to WPS, because these are pass-through payments from the U.S. Treasury through WPS to the medical providers who rendered medical service to Medicare beneficiaries.

We agree that the amount of Medicare benefits paid is reported in the revenue section of WPS’s General Ledger and disclosed in notes to its consolidated financial statements. However, the amount of Medicare benefits paid is not included in the net total revenue reported on WPS consolidated financial statements. Further, WPS’s “netting” of Medicare benefits paid from the revenue figure reported on its financial statements is an indication on their part that such payments should not be considered revenue. Therefore, WPS’s use of Medicare benefits paid as

²⁰ FASB Statement of Financial Accounting Concepts No. 6, Paragraph 78, issued December 1985

revenue in the 3FF allocation is inconsistent with the net revenue reported on their consolidated financial statements.

Payroll Percentage Factor

WPS comments

WPS agreed that payroll costs from the Corporate Expense Cost Center (010060) were inappropriately excluded in developing the payroll percentage factor, but they disagree that capitalized payroll costs and payroll costs of subsidiary staff were inappropriately excluded. WPS stated that when the software was capitalized, payroll expenses were properly credited and including the same cost element in both payroll and capitalized payroll would be double counting, that would result in an incorrect 3FF percentage. Further, they contend that payroll costs for staff placed at outside companies should be excluded because: i) they are not management's concern and ii) revenue generated by these staff are considered in the revenue percentage factor.

Office of Inspector General Response

These select payroll costs should not be excluded in developing the payroll percentage. Specifically, the capitalized payroll costs used to develop software does not result in "double counting" as WPS contends, because the 3FF is only applied one time to the RHO pool in allocating these RHO costs to business segments. Likewise, including subsidiary staff payroll costs does not result in "double counting" even though the revenue generated by these staff may be included in the revenue percentage factor. The salaries for these subsidiary staff were payroll costs of this WPS subsidiary. The CAS 403 does not support WPS's argument to exclude capitalized payroll expenses nor the select subsidiary staff payroll expenses. These excluded expenses are recorded as payroll costs on either WPS's or the affected subsidiary's general ledgers.

Net-Book-Value of Assets Percentage Factor

WPS comments

WPS contends that the CAS requirement to average the NBVs from the beginning and ending of each fiscal year cannot be used to calculate this percentage because the Medicare contract is on a different fiscal year than WPS's. As such, WPS states that their methodology is a reasonable alternative.

Office of Inspector General Response

We maintain that, regardless of the difference in fiscal years, WPS is able to determine its NBVs on the dates specified in CAS, and thus is able to comply with this CAS requirement. Furthermore, WPS did not provide justification that their "reasonable alternative" had been discussed with, or approved by, CMS as a special allocation of residual expenses [48 CFR 9904.403-40(c)(3)].

UNALLOWABLE EMPLOYEE INCENTIVE PROGRAM BONUSES AND RELATED FICA TAXES

WPS comments

WPS does not concur that its FACPs be reduced by \$1,819,947 in employee incentive bonuses and related FICA expenses of \$135,106. WPS contends these costs are allowable compensation for personal services under the FAR 31.205-6. They state that the fact these bonuses are tied to corporate-wide profitability is irrelevant to FAR 31.205-6(f), and does not justify questioning the costs. WPS's focus on corporate-wide profitability directly benefits the Medicare program because profitability is achieved by minimizing expenses, thus, the bonuses incentivized employees to increase efficiency and productivity.

Office of Inspector General Response

We acknowledge these EIP bonuses are compensation for personal services in accordance with FAR 31.205-6, however, the bonuses are not allowable Medicare FACP costs because they are not allocable. 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 [FAR 31.201-4]. Subject to the foregoing, a cost is allocable to a Government contract if it is:

- incurred specifically for the contract [FAR 31.201-4(a)];
- benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received [FAR 31.201-4(b)]; or
- necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be found [FAR 31.201-4(c)].

These EIP bonuses were not incurred specifically for the Medicare contract, they did not benefit the Medicare contract, and there is a direct relationship between the EIP bonuses and WPS's other lines of business. The Medicare contract does not require WPS to pay EIP bonuses. Also, WPS did not justify how basing bonuses on profits made in its other lines of business benefitted the Medicare program, thereby making such bonuses allocable. Moreover, the EIP bonuses are directly related to WPS's other lines of business that were profitable. WPS's contract specifies that WPS is to be paid the costs of administering the Medicare program under the principle of neither profit nor loss, so profits on its other lines of business do not benefit the Government, nor is there an equitable relationship between other line profit and the Medicare contract. Since WPS will receive payment in full for all their Medicare costs provided they are allowable, reasonable, allocable and within the amounts established by the Notice of Budget Approval (NOBA), minimizing expenses to achieve profits on other lines of business is irrelevant to the Medicare contract. WPS has not provided evidence that demonstrates increases in efficiency and productivity in the Medicare program that they claim was achieved by WPS's increase in profitability of its other lines of business. Because the EIP bonuses are paid based on achieving

corporate-wide profit goals, they directly contradict the Medicare contract principle of neither profit nor loss, and as such, are not allocable to Medicare.

INCORRECT SALARY ALLOCATIONS

WPS comments

WPS does not concur with reducing the FACP by \$153,888 related to select executive salaries allocations, because they do not agree that these salaries were incorrectly included in the RHO expense pool. WPS contends these senior executives are part of WPS's executive steering team responsible for collectively managing WPS performance in its entirety and not limited to managing their specific business unit "silo". Therefore, they believe these executive salaries are allocable RHO expenses in accordance with CAS [48 CFR § 9904.403-40(b)(6)] because they are not identifiable with any certain specific activities or business segments.

Office of Inspector General Response

We maintain our findings are valid. These select executive salaries can be identified with specific activities or business segments, and therefore, are not allocable residual home office expenses. The job titles of these executives clearly indicate a direct and specific relationship to the specific business unit "silo" they manage. Further, WPS was unable to provide us with job descriptions or performance plans that define the job duties, functions, and activities of these executives to support its contention that these executives collectively manage WPS's performance in its entirety.

UNSUPPORTED FACP COST ADJUSTMENTS

WPS comments

WPS does not concur that the \$20,082 in FACP cost adjustments should be questioned. However, WPS does agree these adjustments were not adequately supported to move the cost to the previous year (forward funding). WPS contends the costs were appropriately documented legacy contract costs and therefore allowable in the year the cost was incurred.

Office of Inspector General Response

We disagree that these costs were allowable and appropriately documented. WPS did not provide support during the audit or in its response that identified what costs were incurred, moved, and claimed.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

WPS claimed Part B administrative costs to CMS totaling \$115,123,391 during our audit period, October 1, 2008, through September 30, 2011 which included pension costs of \$3,144,284 that were not reviewed. These pension costs will be the subject of a separate review to determine their allowability. Therefore, we reviewed \$111,979,107 in administrative costs. We limited our internal control review to those controls related to the recording and reporting of costs on the cost proposals. We accomplished our objective through judgmental testing.

We conducted fieldwork at WPS's facility in Madison, WI from February 2013 through December 2014.

METHODOLOGY

To accomplish our objective, we:

- reviewed applicable Medicare laws, regulations and guidelines;
- reviewed WPS's contract with CMS;
- reviewed WPS's external audit reports for calendar years 2008, 2009, 2010, and 2011 and the Office of Inspector General audit reports for Federal FY 2007 and 2008;
- interviewed WPS officials regarding cost accumulation processes for its cost proposal and cost allocation system;
- reconciled line item expenses on the cost proposal and cost classification report to WPS accounting records;
- reviewed 100 sample items, testing costs for reasonableness, allowability, and allocability by reviewing contracts and agreements, payroll journals, corporate bonus plans and personnel records. We judgmentally sampled from 12 cost centers and expanded our review as necessary. After determining the cost centers, we identified a month in each FY from which the sample items were selected. The months selected were November 2008, July 2010, and April 2011.
- reviewed residual home office expenses allocated to the administrative cost proposals by analyzing the contractor's application of the three-factor formula (3FF) allocation method described in Cost Accounting Standard 403;
- analyzed WPS's methodology for developing 3FF rates for a selected month;
- requested and reviewed available performance plans or job descriptions;

- reviewed select top management group meeting minutes; and
- reviewed total compensation paid to the highest paid executives.

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 objectives.

APPENDIX B: MEDICARE CONTRACT PROVISIONS AND FEDERAL REGULATIONS

Medicare Contract HCFA 87-032-2 Provisions

Contract HCFA 87-032-2 documents the Medicare Part B claims processing activities performed by WPS. Specifically the contract stipulates:

The Carrier shall receive, disburse, and account for funds in making payment for services furnished to the eligible individuals within the jurisdiction of the Carrier (Article II, Paragraph A).

The Secretary shall provide funds to the Carrier for making payments to providers of services and eligible individuals and for the Carrier's cost of administering this contract (Article III, Paragraph A).

The Carrier shall not use its position as a Medicare contractor for purposes of furthering its private business interests or for profit or gain, nor shall the Carrier use any materials or information it obtains from the Secretary or develops in performing its functions under this contract to promote its private business interest (Article X, Paragraph D). Further, it is the intent of this contract that the Carrier, in performing its functions under this contract, shall be paid its cost of administration under the principle of neither profit nor loss to the Carrier (Article XV, Paragraph A).

In determining allowable costs, the Secretary shall take into account the amount which is reasonable and adequate to meet the cost which must be incurred by an efficiently and economically operated Carrier in carrying out the terms of this contract. The types of costs allowable and allocable under this contract shall be determined in accordance with the provisions of part 31 of the FAR, as interpreted and modified by Appendix B to this contract (Article XV, Paragraph B). Any costs which are properly chargeable by a provider of services as benefit costs in accordance with the Act and Regulations shall not be chargeable to this contract as administrative costs (Article XV, Paragraph D).

Under Article XVI - "Cost of Administration", Paragraph K, it states: The Carrier, as soon as possible, but not later than 3 months after the close of the Federal fiscal year, unless the Secretary approves a different time period or fiscal year, shall submit to the Secretary a Final Administrative Cost Proposal, including supporting data, of the allowable costs incurred by it during the Federal fiscal year. . . .

The Carrier shall maintain adequate accounting records covering the use of funds under this contract for three years after final payment on the contract (Article XX, Paragraph A).

Appendix A, Article V states in part:

...No part of any funds under this agreement shall be used to pay the salaries or expenses of any Contractor, or agent acting for the Contractor, to engage in any activity designed to influence legislation or appropriations pending before the Congress. Lobbying costs are defined in and are unallowable in accordance with FAR 31.205-22.

Appendix B § I, Paragraph A states in part:

The types of costs allowable and allocable under this agreement/contract shall be determined in accordance with the provisions of part 31 of the Federal Acquisition Regulation...

Appendix B § XV identifies specific unallowable items and states in part:

The following items are unallowable:

- A. All direct and indirect costs which relate to the contractor's non-Medicare business and do not contribute to the Medicare agreement/contract. These include, but are not limited to:
 - ...3. costs relating to the contractor's underwriting activities, including related actuarial and statistical services...

Cost Accounting Standard (CAS) 403

According to Cost Accounting Standard (CAS) 403, entitled "Allocation of home office expenses to segments", the 3FF is an arithmetical average of three specified factors: payroll factor, revenue factor, and net book value of assets factor. These factors are defined at 48 CFR 9904.403-50(c)(1) as follows:

- (i) The percentage of the segment's payroll dollars to the total payroll dollars of all segments.
- (ii) The percentage of the segment's operating revenue to the total operating revenue of all segments. For this purpose, the operating revenue of any segment shall include amounts charged to other segments and shall be reduced by amounts charged by other segments for purchases.
- (iii) The percentage of the average net book value of the sum of the segment's tangible capital assets plus inventories to the total average net book value of such assets of all segments. Property held primarily for leasing to others shall be excluded from the computation. The average net book value shall be the average of the net book value at the beginning of the organization's fiscal year and the net book value at the end of the year.

Furthermore, 48 CFR 9904.403-30(a) defines operating revenue as:

- (3) . . . amounts accrued or charged to customers, clients, and tenants, for the sale of products manufactured or purchased for resale, for services, and for rentals of property held primarily for leasing to others. . . .

48 CFR 9904.403-40(c)(3) suggests that where a particular segment receives significantly more or less benefit from residual expenses than would be reflected using the 3FF, the Government and the contractor may agree to a special allocation of residual expenses to such segment commensurate with the benefits received.

Federal Acquisition Regulations (FAR)

FAR 31.201-2, entitled “Determining Allowability”, states:

- (a) A cost is allowable only when the cost complies with all of the following requirements:
 - (1) Reasonableness.
 - (2) Allocability.
 - (3) Standards promulgated by the CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances.
 - (4) Terms of the contract....

FAR 31.201-2, entitled “Determining Allowability”, states:

(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....The contracting officer may disallow all or part of a claimed cost that is inadequately supported.

FAR 31.201-3, entitled “Determining Reasonableness”, states:

- (a) A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business....
- (b) What is reasonable depends upon a variety of considerations and circumstances, including—
 - (1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor’s business or the contract performance;
 - (2) Generally accepted sound business practices, arm’s-length bargaining, and Federal and State laws and regulations;
 - (3) The contractor’s responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and
 - (4) Any significant deviations from the contractor’s established practices.

FAR 31.201-4, entitled “Determining Allocability”, states:

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.

FAR 31.201-6, entitled, “Accounting for Unallowable Costs”, states:

(a) Costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract. A directly associated cost is any cost that is generated solely as a result of incurring another cost, and that would not have been incurred had the other cost not been incurred. When an unallowable cost is incurred, its directly associated costs are also unallowable. . . .

FAR 31.202, entitled, “Direct Costs” states:

- (a) No final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose in like circumstances have been included in any indirect cost pool to be allocated to that or any other final cost objective. Direct costs of the contract shall be charged directly to the contract. All costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly.
- (b) For reasons of practicality, the contractor may treat any direct cost of a minor dollar amount as an indirect cost if the accounting treatment—
 - (1) Is consistently applied to all final cost objectives; and
 - (2) Produces substantially the same results as treating the cost as a direct cost.

FAR 31.205-1, entitled, “Public Relations and Advertising Costs”, discusses the allowability of public relations and advertising costs. It provides that public relations and advertising costs not specifically required by the contract are unallowable.

FAR 31.205-6, entitled, “Compensation for Personal Services”, states:

- (f) *Bonuses and incentive compensation.*
 - (1) Bonuses and incentive compensation are allowable provided the—
 - (i) Awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment; and
 - (ii) Basis for the award is supported.

(m) *Fringe benefits:*

- (2) That portion of the cost of company-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable regardless of whether the cost is reported as taxable income to the employees (see FAR 31.205-46(d)).

FAR 31.205-8, entitled, “Contributions or Donations”, states:

Contributions or donations, including cash, property and services, regardless of recipient, are unallowable, except as provided in FAR 31.205-1(e)(3).

FAR 31.205-1(e)(3) states: costs of participation in community service activities such as blood bank drives, charity drives, savings bond drives, disaster assistance, and etc. are allowable.

FAR 31.205-22, entitled, “Lobbying and Political Activity Costs”, states:

(a) Costs associated with the following activities are unallowable:

- (1) Attempts to influence the outcomes of any Federal, State, or local election, referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activities;
- (2) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections;
- (3) Any attempt to influence—
 - (i) The introduction of Federal, state, or local legislation, or ...

CMS Medicare Financial Management Manual

The CMS *Medicare Financial Management Manual*, chapter 1 § 90.9M, Forward Funding, states the contractor shall include the outstanding costs to be incurred for CMS-approved items for which funding has been received, but the services extend into the subsequent FY. As costs are incurred, these costs should be reported in their appropriate cost categories thus reducing the forward funding balance. When the project is completed all the costs should be removed from the forward funding category and there would be no difference between total costs and total adjusted costs. If CMS has approved projects for forward funding, then costs must be reported on the September Interim Expenditure Report (IER) and the FACP.

Chapter 1, section 180, entitled “Completing the Cost Classification Report, Form CMS-2580” provides instructions on how this form is to be completed. Specifically, section 180.7 states the contractor shall identify pension plan expenses included in fringe benefits.

Chapter 1, section 250, entitled “The Notice of Budget Approval (NOBA)”, in part states:

A NOBA is issued by CMS to notify contractors of approved amounts for PM and MIP administrative expenses for the FY, including the amount of funds certified to be available. Contractors are not authorized to incur expenses in excess of the total certified amount for PM or MIP.

Chapter 1, section 250.1, entitled “End of FY NOBA”, in part states:

If the administrative cost reported in the October - September IER or FACP exceeds the total approved budget, the contractor shall justify the over expenditure to the RO with a copy to CO. CMS reviews the over expenditure for adherence to contract provisions on prior notice and abatement and other considerations and, where appropriate, issues a revised NOBA that enables the contractor to draw additional funds.

The incidences of such end-of-year over-expenditures are few since notification is necessary more than 60 days prior to the end of the FY if either CMS or the contractor expects that the budgeted amounts are not sufficient to cover administrative costs.

Chapter 2, section 140, entitled “Supporting Documentation for the FACP”, states:

If there are any variances between the September IER and the FACP, e.g., charges or credits or other adjustments that may have been received after the close of the FY, the contractor shall prepare a detailed narrative explanation. If total costs claimed are more than the NOBA for the FY, it shall include a justification for the additional requested funds.

Chapter 2, section 190.1, entitled “Examination of Records”, states that the Secretary “shall have access to and the right to examine those books, records, documents and other supporting data which will permit adequate evaluation of the cost or pricing data submitted. . . . The purpose of the examination shall be to verify that cost or pricing data submitted in conjunction with the negotiation of the agreement, including changes thereto, and the preparation of any fiscal report or settlement, are accurate, complete, and current. The right to examination of records shall continue as long as records are maintained.”

Chapter 2, section 190.3, entitled “Records Maintained”, states:

The intermediary or carrier shall maintain books, records, documents and other evidence pertaining to the costs and expenses of the agreement, as well as accounting procedures and practices (hereinafter collectively called “records”). These records shall be maintained to the extent and in such detail as will properly reflect all net costs, direct and indirect, of labor, materials, equipment, supplies and services, and other costs and expenses of whatever nature claimed to have been incurred, and for which reimbursement is claimed under the provisions of the agreement.

Chapter 2, section 190.4, entitled “Availability of Records”, states:

The intermediary’s or carrier’s facilities, or such part thereof as may be engaged in the performance of the agreement, and its records shall be subject at all reasonable times to inspection and audit by the Secretary.

APPENDIX C: COSTS REPORTED ON FINAL ADMINISTRATIVE COST PROPOSALS (FACPs) BY COST CLASSIFICATION

Cost Category	FY 2009²¹	FY 2010²²	FY 2011²³	Total
Salaries/Wages	\$18,402,458	\$19,893,561	\$20,481,314	\$58,777,333
Fringe Benefits	8,008,599	9,558,505	9,930,575	27,497,679
Pension Costs	1,417,662	954,701	892,978	3,265,341
Facilities/Occupancy	1,652,279	1,853,945	1,920,942	5,427,166
EDP	4,578,899	5,346,552	5,700,987	15,626,438
Subcontractors	16,509,671	10,639,624	11,782,104	38,931,399
Outside Prof Services	2,667,403	2,157,762	2,082,226	6,907,391
Telephone/Telegraph	367,501	464,233	514,614	1,346,348
Postage and Express	3,007,882	2,987,261	2,652,270	8,647,413
Furniture and Equipment	4,049,325	4,192,127	4,740,369	12,981,821
Materials & Supplies	1,643,026	1,337,885	624,171	3,605,082
Travel	349,960	300,217	242,865	893,042
Return on Investment	0	0	17,055	17,055
Miscellaneous	681,841	410,514	(52,441)	1,039,914
Other	86,871	108,292	122,713	317,876
Subtotal	\$63,423,377	\$60,205,179	\$61,652,742	\$185,281,298
Credits	(24,201,101)	(24,085,385)	(21,871,860)	(70,158,346)
Forward Funding	439	0	0	439
Total Costs Claimed	\$39,222,715	\$36,119,794	\$39,780,882	\$115,123,391
Pension Costs Excluded ²⁴	(1,369,832)	(918,900)	(855,552)	(3,144,284)
Total Costs Reviewed	\$37,852,883	\$35,200,894	\$38,925,330	\$111,979,107
OIG Cost Adjustments ²⁵	(1,608,408)	(1,368,333)	(1,801,280)	(4,778,021)
Total Accepted Costs	\$36,244,475	\$33,832,561	\$37,124,050	\$107,201,086

²¹ The FY 2009 FACP was based on Supplement Number 06.

²² The FY 2010 FACP was based on Supplement Number 05.

²³ The FY 2011 FACP was based on Supplement Number 06.

²⁴ WPS claimed pension costs of \$3,265,341 that included \$234,393 in pension costs that were allocated from the RHO expense pools using overstated allocation factors. As a result, we recommend reducing the Part B FACPs by \$121,057 in pension costs (\$47,830 in FY 2009, \$35,801 in 2010, and \$37,426 in 2011) that were included in the RHO expense pools. Accordingly, we excluded from our review pension costs totaling \$3,144,284 that will be the subject of a separate review to determine allowability.

²⁵ See Appendix D.

**APPENDIX D: OFFICE OF INSPECTOR GENERAL
RECOMMENDED COST ADJUSTMENTS**

<u>OIG Cost Adjustments</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>Total</u>
RHO Expenses ²⁶	\$893,556	\$819,930	\$856,529	\$2,570,015
EIP Bonuses	546,015	447,298	826,634	1,819,947
FICA Taxes	41,599	32,832	60,675	135,106
Salary Allocations	77,572	34,377	41,939	153,888
Lobbying Salaries	11,216	11,301	12,263	34,780
Auto Leases	25,482	6,793		32,275
Dues and Donations	5,040	3,209	3,096	11,345
FACP Adjustments	7,489	12,593		20,082
Forward Funding	439			439
Meals			144	144
OIG Cost Adjustments²⁷	<u>\$1,608,408</u>	<u>\$1,368,333</u>	<u>\$1,801,280</u>	<u>\$4,778,021</u>

²⁶ The residual home office expenses include \$121,057 in pension costs (\$47,830 in FY 2009, \$35,801 in 2010, and \$37,426 in 2011) caused by WPS using overstated 3FF rates to allocate RHO expenses.

²⁷See Appendix C for how these adjustments effect the FACP's that were audited.

APPENDIX E: WISCONSIN PHYSICIANS SERVICE INSURANCE CORPORATION COMMENTS



Medicare

June 25, 2015

Ms. Sheri L. Fulcher
Regional Inspector General for Audit Services
HHS, Office of Audit Services, Region V
233 North Michigan Avenue, Suite 1360
Chicago, IL 60601

Re: **Wisconsin Physicians Service Insurance Corporation;**
Draft OIG Report Number A-05-13-00019

Dear Ms. Fulcher:

In a letter dated May 29, 2015, we received the Office of Inspector General's draft report entitled *Wisconsin Physicians Service Insurance Corporation Claimed Unallowable Medicare Part-B Administrative Costs for FYs 2009, 2010, and 2011* under Contract No. HCFA 87-032-2 (the "Legacy Contract"). In that letter you requested we respond to you and include a statement of concurrence or nonconcurrence for each recommendation, WPS has included these statements below in the same order the recommendations appear in the draft report.

WPS Did Not Overstate Its Residual Home Office Expenses.

WPS does not concur with the OIG recommendation to reduce its costs by \$2,570,015 related to residual home office expenses.

Revenue Percentage.

WPS did not overstate its residual home office expenses for any year. First, the Draft Audit Report applies the wrong standard because the Legacy Contracts are not subject to Cost Accounting Standard ("CAS") 403. Part B Contract, Art. XV, ¶ B & App. B (incorporating by reference CAS 412 and 413 and reciting CAS 401 and 402, but including no reference or recitation of CAS 403 or other CAS). Instead, the Legacy Contract requires only that WPS's method of allocating indirect costs be "equitable, reasonable, and in accord with the general accepted accounting principles." Part B Contract, Art. XV, ¶ B. DCAA audited and approved WPS's residual home office expense allocation method on multiple occasions, including during the time periods that are subject to OIG's audit report:

- In 2007, in connection with WPS's J5 MAC proposal, DCAA performed an adequacy and compliance audit of WPS's disclosure statement, and specifically verified that WPS's allocation of home office costs complies with CAS 403. WPS and DCAA specifically discussed WPS's application of the three-factor formula and WPS's practice of including benefits paid in Medicare operating revenue. DCAA specifically concluded that WPS's practice was appropriate.



Wisconsin Physicians Service Insurance Corporation serving as a CMS Medicare Contractor
P.O. Box 1787 • Madison, WI 53701 • Phone 608-221-4711

- In 2007-2008, DCAA conducted an audit of WPS's Home Office Disclosure Statement, which specifically identified that "Benefits Paid" and "Claims Paid" were components of revenue. DCAA concluded that WPS's disclosed practices complied with CAS and FAR Part 31.

- In 2010, DCAA and WPS entered into an agreement finalizing WPS's indirect rates for FY 2007. The agreed-to rates were developed based on WPS's established practice of including benefits paid in Medicare operating revenue.

- WPS has undergone a number of audits of its forward pricing rates for TRICARE, with the most recent audit completed in 2013. Neither DCMA nor DCAA have questioned WPS's application of the three-factor formula as part of any of these audits or in connection with any of WPS's forward pricing rate agreements.

DCAA was the Cognizant Federal Audit Agency for WPS's TRICARE segment during the time periods in question, and is a leading authority on Government cost accounting. Even assuming that DCAA and OIG could reasonably disagree on this matter, the fact that DCAA endorsed WPS's allocation method in and of itself confirms that WPS's approach is, at a minimum, equitable, reasonable, and in accord with the general accepted accounting principles.

Regardless, WPS's allocation method fully complies with CAS 403. CAS 403's "three-factor formula" instructs contractors to allocate residual home office expense costs in proportion to "three broad areas of management concern: [1] The employees of the organization, [2] the business volume, and [3] the capital invested in the organization." 48 C.F.R. 9904.403-50(c)(1). CAS 403 prescribes three business metrics as proxies for these "three broad areas of management concern"—payroll dollars, operating revenue, and net book value—and requires that contractors average the share of each metric attributable to a particular cost objective.

Including "Medicare benefits paid" in the second factor—the factor aimed at capturing "business volume"—complies with CAS 403 without question. For a company whose primary function is to process and pay claims for health care benefits, common sense dictates that the amount of benefits paid is the best metric of the company's business volume. Only by including benefits paid within operating revenue can WPS equitably measure the business volume of its various units. For example, for units within WPS that sell insurance and then pay claims out of the proceeds from the insurance, WPS includes all of the insurance proceeds as operating revenue, which includes both the amount retained by WPS and the amount paid out for claims. For units within WPS that provide administrative services and pay claims, not out of insurance proceeds, but out of funds provided by a third party (such as Medicare), WPS includes the full amount paid by the third party, which likewise includes both the amount retained by WPS and the amount paid out for claims. The only difference between these two models is the source of funds for payment, but that has no bearing whatsoever on WPS's "business volume." Instead, WPS's business volume is the value of the claims it processes. All of the claims paid by WPS, whether Medicare, commercial, or other, flow through WPS and are recorded on WPS's books as revenue.

The value of those claims is the only reasonable metric of WPS's business volume for purposes of CAS 403. This is precisely the conclusion reached by DCAA, which has specifically audited WPS's disclosed accounting practices for home office allocations, and concluded time and again that those

practices comply with CAS 403 (unlike WPS's legacy Medicare contracts, the Department of Defense considers WPS's TRICARE contracts subject to CAS). By disagreeing with DCAA, OIG would compel WPS to depart from the disclosed accounting practices that WPS was contractually obligated to follow under its TRICARE contracts. WPS should not be given the Hobson's choice of deciding which agency's interpretation of CAS 403 to follow, particularly where WPS is dutifully following the interpretation of the agency whose contracts are actually subject to CAS 403.

Finally, OIG's draft report erroneously states that "WPS's treatment of the Medicare benefit claims paid as operating revenue is inconsistent with reported Medicare revenue on its consolidated financial statements." Draft Report at 5. WPS presents *net* revenue (as opposed to *gross* revenue) on its consolidated statements of earnings for financial reporting purposes. See Emerging Issues Task Force ("EITF") Issue Number 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent." In the notes to its consolidated financial statements, WPS explicitly identifies the total claims paid under administrative service only contracts. Similarly, on its General Ledger, WPS includes benefits payments as "Medicare Claims Reimbursement" within the revenue section of its General Ledger. WPS's accounting practices for financial reporting purposes are therefore entirely consistent with WPS's established practice for allocating home office expenses to its Medicare and TRICARE contracts.

Payroll Percentage.

The Draft Audit Report contends the payroll percentage factors were calculated incorrectly due to 1) excluding costs in the corporate expense cost center, 2) excluding capitalized payroll costs for internally developed software, and 3) the Staffing subsidiary people placed with other companies were excluded. WPS concurs with the first observation and does not concur with the last two observations.

#1, WPS now records the bonus accrual in each individual cost center so that this Payroll from the corporate expense cost center is not excluded.

The objective of the three factor formula is to capture the three broad areas of management concern. OIG observation #2 states that internally developed capitalized software should be included with both the payroll factor and the net book value factor. WPS feels this is double counting. When internally developed software is capitalized, payroll expenses are properly credited. WPS accounted appropriately in this manner when developing the payroll factor. Including the same cost element in multiple factors (#2 Payroll and Capitalized Payroll) as the draft report contends will incorrectly double count that Payroll cost element resulting in an incorrect three factor formula percent.

The Staffing subsidiary (#3) people placed with other companies are not the responsibility of WPS management and not in any way of WPS management's concern. These people are temporary help workers placed with external companies and would be more akin to cost of goods sold than a payroll expense. WPS has correctly included the revenue generated by placing these staff at other companies in the Revenue factor. Including these costs in the Payroll factor results in an unreasonable three factor formula percentage.

Net-Book-Value of Assets Percentage.

The Draft audit report contends the Net Book Value of Assets Factors were calculated incorrectly. CAS 403-50(c)(1)(iii) states the NBV of assets shall be the average of the NBV at the beginning of the organization's fiscal year and the NBV at the end of the year. The legacy contracts require costs be reported based on the federal fiscal year and not on the organization's fiscal year as required in the standard. Therefore, a literal application of the CAS standard is not possible and also remain in compliance with the legacy contract requirements. WPS calculated the NBV of assets using each months NBV for the government's fiscal year time period. This is more accurate than the NBV at the beginning of the federal fiscal year and the NBV at the end of the federal fiscal year and is a reasonable alternative since the CAS standard cannot be used.

WPS's Employee Incentive Program Bonuses and Related FICA Taxes Are Allowable

WPS does not concur with the OIG recommendation to reduce its costs by \$1,819,947 related to employee incentive plan bonuses and by \$135,106 related to FICA taxes.

The Draft Audit Report argues that the costs of WPS's Employee Incentive Program are unallowable because they do not "benefit[]" the Medicare contract and because WPS's use of corporate-wide profitability as a metric for determining whether it will pay bonuses is inconsistent "with the contracts' stated intent that the carrier/intermediary be paid the costs of administration under the principle of neither profit nor loss." WPS does not believe that either argument justifies questioning these costs.

As a threshold matter, bonuses are an aspect of each employee's "compensation for personal services." FAR 31.205-6(f). So long as they comply with FAR 31.205-6(f), these bonuses are allocable to the Legacy Contracts just as those same employees' salaries are allocable to the Legacy Contracts. The bonuses "benefit" the Legacy Contracts just as much as the other elements of the employees' compensation. The fact that bonuses are tied to corporate-wide profitability is irrelevant under FAR 31.205-6(f) and does not provide a basis to disallow these costs. Profit is nothing more than the sum of income less expenses, and minimizing expenses is consistent with, and indeed beneficial to, the Legacy Contracts. WPS's focus on corporate-wide profitability directly benefits the Medicare program by incentivizing employees to increase efficiency and productivity.

Regardless, WPS's bonus program is not inconsistent with the "principle of neither profit nor loss." WPS is seeking reimbursement for compensation costs actually paid to the employees, not for additional money that will add to corporate-wide profit. Indeed, because WPS has paid these bonuses as part of the employees' compensation package, disallowing these costs violates the principle of "neither profit nor loss" because, under OIG's approach, WPS must now absorb these compensation costs as a loss.

Salary Allocations

WPS does not concur with the OIG recommendation to reduce its costs by \$153,888 related to Salary Allocations included in the home office residual pool.

Select salaries were not incorrectly included in the RHO expense pool. OIG references FAR 31.201-4 that describes cost are allocable if assignable on a benefits received basis or other equitable relationship. The select salaries are for CAS 9904.403-40(b)(6) "Staff management not identifiable with any certain specific activities of segments". Senior WPS executives are part of the executive steering team responsible for collectively managing performance WPS in its entirety. To accomplish this they integrate best practices, processes, and policies across all WPS business segments and collaborate to coordinate corporate resources in line with the corporate strategic plan. This demonstrates that the senior executives are not limited to managing their specific business unit "silo", but are indeed significantly involved in the management of WPS as a whole, which benefits all segments, including Medicare.

Lobbying Salaries

WPS concurs the lobbying salaries are unallowable. Going forward the individual involved has been moved to the lobbying cost center whose costs are treated as unallowable.

Auto Leases

WPS concurs the auto lease costs are unallowable. Due to the timing of the prior audit report, the calendar year 2009 leased auto costs claimed for personal use had not been adjusted, impacting the federal fiscal years 2009 and 2010. WPS has been adjusting the personal use costs as unallowable since calendar year 2010.

Membership Dues

WPS concurs the lobbying portion of membership dues are unallowable; there were some instances where this situation was not identified on the vouchers. WPS will remind accounts payable staff lobbying costs are unallowable.

FACP Adjustments

WPS does not concur with the FACP amount questioned. OIG questioned the support for moving some costs from one year to a previous year. While WPS agrees the FACP adjustments were not adequately supported to move the cost to the previous year (forward funding), the cost is still an appropriately documented legacy contract cost and therefore is allowable in the year the cost was incurred.

Duplicate Forward Funding

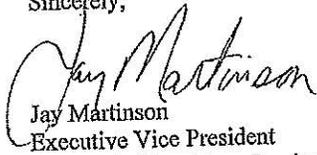
WPS concurs with the duplicate forward funding amount of \$439. The COBC credits for the MACs are now reported on a cash basis verses accruals for the legacy contracts and this issue will not occur going forward.

Meals

WPS concurs with the meals amount of \$144. A portion of a donation was related to a meal and that cost was moved to meals for tax reporting, in this particular case the cost center was also changed. WPS will remind staff that all donation amounts remain in the donation cost center.

Should you have any questions regarding these comments, please contact Pete Shackelford at 608-226-2638 or pete.shackelford@wpsic.com.

Sincerely,



Jay Martinson
Executive Vice President
Wisconsin Physicians Service Insurance Corporation