DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

JUN 28 2004

TO: Wynethea Walker
Acting Director, Audit Liaison Staff
Centers for Medicare & Medicaid Services

FROM: Joseph E. Vengrin
Deputy Inspector General for Audit Services

SUBJECT: Blue Cross and Blue Shield of Texas Pension Segment Closing Audit (A-07-02-03032)

Attached is an advance copy of our final report on the Blue Cross and Blue Shield of Texas (Texas) pension segment closing. We will issue this report to the Health Care Service Corporation, of which Texas is now a division, within 5 business days. We suggest that you share this report with the Centers for Medicare & Medicaid Services components involved with monitoring the Medicare contractors' financial operations, particularly the Office of Financial Management, the Center for Medicare Management, and the Office of the Actuary.

Until its Medicare contracts were terminated in 1999, Texas was allowed to claim reimbursement for its Medicare employees' pension costs. According to Federal regulations and the Medicare contracts, pension gains that occur when a Medicare segment of a pension plan closes must be credited to the Medicare program.

Our objective was to quantify any excess assets that Texas should remit to Medicare as a result of the termination of the Medicare contractual relationship.

Texas originally identified excess Medicare pension assets of $10,753,575. However, in response to our draft report, Texas revised its calculation and indicated that the correct figure was $11,152,093. We determined that the revised figure was materially correct and recommended that Texas remit $11,152,093 to the Federal Government for excess Medicare pension assets.

If you have any questions or comments about this report, please do not hesitate to call me or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or James P. Aasmundstad, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591, ext. 225. Please refer to report number A-07-02-03032 in all correspondence.

Attachment

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

JUN 30 2004

Report Number: A-07-02-03032

Ms. Susan E. Gajda
Vice President
Audit and Performance Services
Health Care Service Corporation
300 East Randolph Street, 11th Floor
Chicago, Illinois 60601-5099

Dear Ms. Gajda:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Blue Cross and Blue Shield of Texas Pension Segment Closing Audit." A copy of this report will be forwarded to the HHS action official noted below 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 the action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent the information is not subject to exemptions in the Act that the Department chooses to exercise (see 45 CFR part 5).

Please refer to report number A-07-02-03032 in all correspondence.

Sincerely yours,

James P. Aasmundstad
Regional Inspector General
for Audit Services

Enclosures - as stated

Direct Reply to HHS Action Official:

James R. Farris, M.D.
Regional Administrator
Centers for Medicare & Medicaid Services
1301 Young Street, Room 714
Dallas, Texas 75202

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

BLUE CROSS AND BLUE SHIELD OF TEXAS PENSION SEGMENT CLOSING AUDIT

JUNE 2004
A-07-02-03032

Office of Inspector General

http://oig.hhs.gov

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The OIG's Office of Audit Services (OAS) provides all 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 in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the department.

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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 in OIG's internal operations. The OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within the department. The OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops model compliance plans, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
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In accordance with the principles of the Freedom of Information Act, 5 U.S.C. 552, as amended by Public Law 104-231, Office of Inspector General, Office of Audit Services, reports are made available to members of the public to the extent information contained therein is not subject to exemptions in the Act. (See 45 CFR Part 5.)

OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed as well as other conclusions and recommendations in this report represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the awarding agency will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

Since its inception, Medicare has paid a portion of the annual contributions that contractors make to their pension plans. In claiming cost reimbursement, contractors are to follow the principles contained in the Federal Acquisition Regulations (FAR), the Cost Accounting Standards (CAS), and the Medicare contracts. Pension plan payments represent allowable pension costs under FAR.

The Centers for Medicare & Medicaid Services (CMS) incorporated segmentation requirements into Medicare contracts starting with fiscal year (FY) 1988. The Medicare contracts define a segment and require separate identification of the pension assets for the Medicare segment, including the methodology for the initial allocation of pension assets to the Medicare segment. The contracts further require that, in accordance with CAS 413, the Medicare segment assets be updated for each year after the initial allocation. In addition, the Medicare contracts and FAR require contractors to remit excess Medicare pension assets to the Federal Government in situations such as contract terminations.

Blue Cross and Blue Shield of Texas (Texas) administered Medicare Part A and Part B operations under cost reimbursement contracts until its contractual relationship with CMS was terminated on September 30, 1999.

OBJECTIVE

Our objective was to quantify any excess assets that Texas should remit to Medicare as a result of the termination of the Medicare contractual relationship.

FINDING

As a result of the termination of the Medicare contracts, Texas identified $11,152,093 in excess pension assets as of September 30, 1999. We determined that this figure was materially accurate. As required by the Medicare contracts and FAR, these excess assets should be credited to the Medicare program.

RECOMMENDATION

We recommend that Texas remit $11,152,093 to the Federal Government for excess Medicare pension assets.

AUDITEE'S COMMENTS

Texas noted that the summary spreadsheet that it used to identify excess Medicare pension assets of $10,753,575 failed to include attributable allocation percentages for the "other" segment. According to Texas, the correct figure was $11,152,093. Texas's comments are included in their entirety as an appendix.

OFFICE OF INSPECTOR GENERAL RESPONSE

We determined that Texas's revised figure was materially correct. Therefore, Texas should remit $11,152,093 to the Federal Government.

TABLE OF CONTENTS

Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
FAR	Federal Acquisition Regulations
FY	fiscal year

INTRODUCTION

BACKGROUND

Medicare Program

Texas administered Medicare Part A and Part B operations under cost reimbursement contracts from the start of the Medicare program until its contractual relationship with CMS was terminated on September 30, 1999. Since its inception, Medicare has paid a portion of the annual contributions that contractors make to their pension plans. In claiming cost reimbursement, contractors are to follow the principles contained in FAR, CAS, and the Medicare contracts. Pension plan payments represent allowable pension costs under FAR. In 1980, both FAR and the Medicare contracts incorporated CAS 412 and 413.[1]

CMS incorporated segmentation requirements into Medicare contracts starting with FY 1988. The Medicare contracts define a segment and require separate identification of the pension assets for the Medicare segment,[2] including the methodology for the initial allocation of pension assets to the Medicare segment. The contracts further require that, in accordance with CAS 413, the Medicare segment assets be updated for each year after the initial allocation.

Regulations

CAS 9904.413-50(c)(12) addresses contract terminations and segment closings and states:

> If a segment is closed . . . the contractor shall determine the difference between the actuarial accrued liability for the segment and the market value of the assets allocated to the segment, irrespective of whether or not the pension plan is terminated. The difference between the market value of the assets and the actuarial accrued liability for the segment represents an adjustment of previously determined pension costs.
>
> (i) The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with the current and prior long-term assumptions used in the measurement of pension costs . . . .

[1] CAS 412 regulates the determination and measurement of the components of pension costs. It also regulates the assignment of pension costs to appropriate accounting periods. CAS 413 regulates the valuation of pension assets, the allocation of pension costs to segments of an organization, the adjustment of pension costs for actuarial gains and losses, and the assignment of gains and losses to cost accounting periods.

[2] According to the Medicare contracts:

> The term "Medicare segment" shall mean any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare agreement/contract, in which:
>
> 1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or
> 2. Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent of more of the total salary dollars allocated to the Medicare agreement/contract.

> (ii) The calculation of the difference between the market value of the assets and the actuarial accrued liability shall be made as of the date of the event (e.g. contract termination, plan amendment, plant closure) that caused the closing of the segment . . . . If such a date is not readily determinable, or if its use can result in an inequitable calculation, the contracting parties shall agree on an appropriate date.

Blue Cross and Blue Shield of Texas

CMS awarded Medicare Part A and Part B contracts to Texas in 1966. Texas formed Trailblazers Health Enterprises, LLC in 1998. Texas merged with the Health Care Service Corporation in 1999. Subsequently, on September 30, 1999, Texas terminated its contract and closed its Medicare segment. Upon the segment's closing, most of its Medicare employees left or transferred to the successor contractor.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to quantify any excess assets that Texas should remit to Medicare as a result of the termination of the Medicare contractual relationship.

Scope

Because Texas's Medicare contract terminated and the Medicare segment closed on September 30, 1999, we determined September 30, 1999 as the appropriate date to measure the segment closing adjustment amount. Therefore, we reviewed Texas's identification of the Medicare segment and update of Medicare assets from April 1, 1994[3] through September 30, 1999.

We did not review Texas's internal control structure because it was not relevant to the objectives of our audit.

Methodology

In conducting our review, we used information provided by Texas's actuarial firm, Watson Wyatt Worldwide. The information included liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We examined Texas's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Forms 5500. Using these documents, we, along with CMS pension actuarial staff, reviewed Texas's update of Medicare segment assets from April 1, 1994 to September 30, 1999 and prepared our own update for the same period. We compared Texas's update with ours to determine the accuracy of Texas's identification of excess pension assets.

[3] We chose April 1, 1994 as the start of our audit period because our previous audit of Texas's pension segmentation (A-07-95-01135, issued July 11, 1995) covered the period up to that date.

CMS pension actuarial staff and we used Texas's historical practices to develop the methodology for computing the Medicare segment excess pension assets.

We conducted this review in conjunction with our review of Texas's pension costs claimed (A-07-03-03046, expected to be issued shortly). The information obtained and reviewed during that audit was also used in performing this review.

We performed our audit in accordance with generally accepted government auditing standards.

FINDING AND RECOMMENDATION

EXCESS PENSION ASSETS

As a result of the termination of its Medicare contracts, Texas identified $11,152,093 in excess Medicare pension assets as of September 30, 1999. Texas's identification of the excess assets is materially accurate.

The Medicare contracts and FAR requires Texas to remit excess Medicare pension assets to the Federal Government. Medicare contracts specifically prohibit any profit (gain) from Medicare activities. Therefore, any pension gains that occur when a Medicare segment closes should revert to the Medicare program. In addition, FAR addresses dispositions of gains in situations such as contract terminations. When excess or surplus assets revert to a contractor as a result of the termination of a defined-benefit pension plan, or such assets are constructively received by a contractor for any reason, the contractor shall refund or credit the Government an amount equal to its equitable share (FAR § 31.205-6(j)(4) and CAS 9904.413-50(c)(12)).

RECOMMENDATION

We recommend that Texas remit $11,152,093 to the Federal Government for excess Medicare pension assets.

AUDITEE'S COMMENTS

Texas noted that the summary spreadsheet that it used to identify excess Medicare pension assets failed to include attributable allocation percentages for the "other" segment. According to Texas, the excess Medicare pension assets should be $11,152,093 instead of the previously submitted $10,753,575. Texas's comments are included in their entirety as an appendix. Texas's comments also address two other Office of Inspector General reports. Our response to those comments is included in the respective reports.

OFFICE OF INSPECTOR GENERAL RESPONSE

We determined that the $11,152,093 in excess Medicare pension assets identified by Texas was materially correct. Therefore, Texas should remit $11,152,093 to the Federal Government.

APPENDIX

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March 30, 2004

James P. Aasmundstad
Regional Inspector General for Audit Services, Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Subject: USDHHS, OIG, OAS Draft Audit Reports related to Blue Cross and Blue Shield Of Texas (former) Medicare Contract (terminated September 30, 1999)--
--Report#A-07-03-03032 titled Blue Cross and Blue Shield of Texas Pension Segment Closing Audit (dated July 2003)(audit#1 of the series below)
--Report#A-07-03-03046 titled Review of Pension Costs Claimed for Medicare Reimbursement by Blue Cross and Blue Shield of Texas, Inc. (dated September 2003)(audit#2 of the series below)
--Report#A-07-03-03040 titled Audit of Post Retirement Benefit Costs Claimed Claimed for Medicare Reimbursement by Blue Cross and Blue Shield of Texas Inc. (dated February 2004)(audit#3 of the series below)

Dear Mr. Aasmundstad:

The subject draft reports, referred to below as audits #1, #2, and #3 in a series respectively, are the result of OIG on-site reviews performed during October 2002 and February 2003 as well as prior and subsequent exchanges of information between OIG (including Office of the Actuary), Blue Cross and Blue Shield of Texas (a Division of Health Care Service Corporation, a Mutual Legal Reserve Company), HCSC's engaged outside Actuarial Consultant (Watson Wyatt), and to some extent Blue Cross and Blue Shield of South Carolina staff (including their outside Actuarial firm Chicago Consulting Actuaries) materially through July and October of 2003. We have remained in periodic contact with the audit team during the intervals of audits, follow-up, and draft series issuance. Our pre-arranged approach and intention was to review and respond to the three audit drafts in the series collectively at the same time based on receipt of the last. We appreciate the OIG/HHS/CMS efforts, cooperation, and professional approach in these matters.

The background information contained in the "Background-Texas" sections of each report (each attached for reference) seems to adequately characterize the history and circumstances leading to these final audits under the Medicare Program, therefore we have not restated that here. Each audit/audit report is very specific to an area of contract cost reimbursement and highly technical in nature. Each audit report incorporates reference to Medicare Program/CMS/HCFA/HHS rules, CAS, FAR, FPR, the actual Medicare Contracts, contractor practices, previous audits, and certain events or transactions which we have reviewed but which we have not attempted to re-

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audit or refute in detail and which we do not attempt to restate or pick-apart in our response.

We view and have approached this series of three audit drafts as related and to an extent interdependent. The three draft reports and the handling of the recommendations collectively address three remaining primary open issues related to or resulting from the termination of the Texas Medicare Contract(s) effective September 30, 1999.

Audit #1 draft identifies "excess" pension plan assets at a point in time associated with Medicare Segmentation and CAS methodologies which the OIG recommends HCSC remit (from corporate assets since that can not/should not occur from the remaining ongoing qualified Pension plan after all former Medicare employees were paid accrued lump sum benefits in full) to the Federal Government (based on the concept that the Government Program had over time actually reimbursed previous pension contribution cost claims pursuant to that "excess" funding).

Audit #2 draft is related to the historical annual allowable administrative cost (pension contributions allocated) claims (FACP based) of BCBSTX and based on the auditors' review of previous governmental cost filings, books, records, methods, audit reports and actuarial data (or retrospectively re-applied auditor methodology against that same information) leads the OIG to recommend that HCSC remit $3,023,483 identified as "unallowable costs" to the Federal Government.

Audit #3 is related to the extraordinary circumstance at contract end when during the directed transition of the Texas Medicare Contract from BCBSTX (TrailBlazer Health Enterprises, LLC a wholly owned subsidiary which held the contract at the time) to Blue Cross and Blue Shield of South Carolina as a condition of transition/sale BCBSTX/HCSC agreed to fund a trust with the actuarially determined accumulated "past service cost" necessary to provide a (future post-retirement) health care benefit upon retirement for transitioned (retained in employment of new contractor) employees and leads the OIG to recommend that BCBSTX (HCSC) withdraw its original previously un-reimbursed estimated cost claim of $6,000,000 ($5,159,732 actual deposited after close).

While associating the results of all three audits in the series is important to conclusion, audit#1and portions of #2 must be tied together and are interlocked in arriving at logical consistent finding. HCSC in conjunction with Watson Wyatt actually calculated and furnished the resulting amount quoted in audit #1 directly from its own maintained valuations and records based on strict collaborative application of techniques required and employed in CAS pension accounting and segmentation rules. The resultant amount is effectively partially based and effectively also partially derived based on the cost computations, allocations, charges, submissions, and reimbursement (and visa versa) along the way. Therefore, if it represents is a good acceptable result, which parties

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already agree it equitably does, then the related basis or pathway leading to it (partially subject of audit#2) is virtually substantiated and if that were to be altered the result could be altered.

Audit #2 has two distinct separate areas it explores for finding. One aspect is purely related to findings/recommendations from a past (last period ending before this audit period begins) pension segmentation audit where parties mutually agreed on valuation and charge techniques under CAS to be employed going forward and which resulted in certain booked adjustments to program costs. As a result of the booked adjustments to program costs a piece (pension plan years and program fiscal years crossed) of the cost adjustment credit the program would receive fell in a prior already filed year. The piece of credit that fell into that previously just filed year was embedded within overall amounts "reduced", not claimed and not reimbursed from that previous year. The adjustment was properly calculated which resulted in a portion being credited into the open year but the properly apportioned amount of the credit amount falling back into the prior program year was not "refunded/refundable/re-reportable" because it was effectively not charged or reimbursed within the actual final FACP. This method of cost reduction-to-unallowable cost offset is acceptable and was actually documented in 1995 HCFA memoranda. We have previously replied to the auditors on this aspect of audit#2 as excerpted again in reply here, as follows:

".....Related to the below your additional question...While researching the records we found that we had apparently received a "Risk Assessment" summary letter with some questions related to the 91-94 reviews (received and replied in 99) which had included among other things a verification of the handling of your same 94 pension audit amount/question. That response (drafted June 99 for HCFA RO Dallas---paraphrased---"HCFA recommends that the FACP's be reduced by $874,111 to reflect an adjustment identified in the pension segment audit....The required adjustment has already been made to the FY 1994 FACP....It was included with various other adjustments on the workpapers which were audited and not separately identified:....There should be no further adjustment for this finding....") was found to be consistent with our initial response to the 94 audit, with follow up correspondence, with the 94 filing workpapers we reviewed, and was accepted by and closed with HCFA. The amount "credited" based on method alignment agreed upon during the audit related to CAS limits for that isolated period versus contributions for that isolated period were properly allocated to the Medicare lines. The actual credit was tabulated based on our consistent allocation method but still represented the underlying theory represented by the 94 audit finding amount (audit finding amount was estimated to be $874,111), and our reply. Our Medicare lines' credit (Total and Medicare lines impact documented in our materials furnished during your current audit) was actually for a total of $1,046,280. The available "Voluntary Cost Reductions" at 9-30-94 were $5,432,232. In essence the FY 94 Medicare charges for pension cost were reduced by $1,046,280. from the original filed FACP reported amounts. We do find the action and amounts as described here to be properly supported in the original FACP workpaper file, in subsequent correspondence, and in the risk assessment reply....."

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The second aspect of audit #2 is much more complicated and required significant review on our part to understand the wording of the finding and the actual auditor calculations/workpapers underlying the auditor's approach and apparent finding. We previously replied in-part to the auditors on this bullet of the early draft as follows: ".....We have invested time carefully reviewing your draft#2, including with Watson Wyatt CAS staff and attempting to reconcile the different numbers and approaches. We have needed to locate/dig back through older FACP files/workpapers to address certain points. Proper consideration of draft/aspect #2 requires a certain amount of correlation with draft/aspect #1, and to an extent with past filings and with past audits.....we have been off and on somewhat perplexed while we examined this draft#2 and have needed to set it aside/pick it back up/reflect over several possible questions/alternatives. We have been careful to take extra time and have considered discussing some of our initial concerns.....it is possible that the best/most efficient way to handle this complicated topic is by written reply protocol.....".

After that and further detail consideration we do not and can not agree (supported firmly by the re-review of our involved, experienced outside Actuary) with the statement made in and throughout the second finding (basically--"Texas not basing its pension claims ...on separately calculated pension costs for the Medicare segment...."). We have in fact consistently based our pension valuations, allocations, computations, and charges on very well engineered, acceptable, agreed, consistent methods aligned with the intent of CAS, in accordance with CAS and equitable to the program involved. These employed methods in our opinion have been previously reviewed/effectively agreed by the OIG during and following prior pension related audits (and which is supported evidenced in prior audits related to years not questioned). After considerable reexamination of all of the historical data used in our original results and furnished during the audit as well as what was furnished back by the auditor we find that: the findings and calculations demonstrated in audit#2finding#2 may in fact first simply miss entirely the actual methodology that was employed by us (allocations to segment and to cost centers within CAS limits actually directly based on individual actuarial assigned pension CAS cost) and how that ties perfectly well into the results of audit #1; the auditor methods are seemly re-applied employing top-sided global desk techniques that we do not fully comprehend nor agree apply consistently in context with our overall factors and outcomes which are based on solid approaches; the auditor approach results IF presumed on the surface to be otherwise validly approached are flawed within themselves because they do not incorporate accurate starting amounts for years 94 and 99 (the auditor apportions pension plan years contribution activity to equate to FY years using arbitrary ½ year conventions ignoring that the numbers on the lead-in year are already set at 56.2% and numbers on the ending truncated/valued short year would be at 100% or at a minimum 99.6% if you discount a trailing contribution adjustment deposit made a month late)(which IF plugged into the auditor formula would result in a surface comparative difference result of $765,539 not $2,149,372 IF method were otherwise accepted).

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However, while having to continue to locate and go back through all of the detail and audit trail involved in re-consideration of the problems presented in audit#2 (which ripples back to audit #1) we have discovered at least two things. One we will herein adjust immediately (revised copy to be furnished electronically for the auditors'/actuary's files). The second may need at least to be carefully considered in context by parties.
First--The summary spreadsheet furnished as supporting audit #1 results titled "Remaining Medicare Assets" failed to copy down a set of attributable allocation percentages only in the "other" column in the early years of 91, 92, 93 immediately following years of 0% and where contribution had re-commenced. This correction results in an additional small attribution of "other" contributions which slightly raises the ending Medicare ending weight ratio applied to ending assets which results in an addition of $398,518 in "Medicare portion of remaining assets" identified or an ending identified remaining asset number of $11,152,093 related to audit#1 vs $10,753,575 reported. Nothing else about the underlying methods or ultimate results changed.
Second—We did not attempt to factor for this circumstance in our calculations but upon discovery of the earlier FACP work papers while researching audit #2 finding#1and#2 it is interesting to note that we were not able to claim the actual properly based equitable pension contribution allocation during past FY 93 (which is crossed by the settlement nature of the audit #1) due to budgetary cost cut-backs and more voluntary cost reductions. Those filing work papers reflect a reduction of $1,258,436 in pension costs not filed/not claimed. This very well could be a factor when considering refunding of identified excess assets it would seem.

Audit #3 presents a dilemma related to laws, regulations, timing, facts and circumstances, what is logical, what is fair, what makes the most sense in context, and intents. BCBSTX exited the Medicare contractor business by agreement after having successfully with much favorable recognition participated in the program since its inception. BCBSTX and the long term employees of its Medicare division had been dedicated and had contributed to the development of the overall program and its operation. The government we think appreciated the efforts described and the government was aware of and participated to an extent in the negotiating of the "transition" of the Texas contact to a comparable contractor. The interest of the transitioning long term employees and the stability of operation of the contract for the Medicare beneficiaries was a paramount concern. Texas management (and SC management) approached the transition carefully within the constraints of operating the program as it advanced. Both parties to the transaction worked ethically to handle the payment and continuation of a form of pension benefits for impacted employees. Both parties sought a way under the rules and past practices to ensure the impacted employees would be able to retain a reasonable form of retiree health benefit.

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The method that surfaced that would ensure retiree health benefit (accruals) for active impacted employees (retired employees by the way were on a pay-as-you-go basis and that future cost was not sought from the government but Texas has continued to pay that cost) was to create/fund a trust fund out-of-corporate-pocket (Texas) in support of past-service cost already actuarially accrued (but not yet claimed or reimbursed under a pay-as-you-go approach) for that benefit for those employees on top of which the new employer would then only need to fund future service cost accruals. Otherwise under the given ongoing possible budgetary constraints of the new employer the benefit might not have been continued based on lengthy prior service. $5,159,732 was funded by BCBSTX/HCSC and handed over to a trust to be operated by the new contractor BCBSSC. The agreement and the trust (which is being modified we now understand by BCBSSC to qualify with OIG instructions/findings) was designed to be tightly monitored and controlled so that the funds and growth could only be used for the specific impacted employees as they worked to fruition. The transition/sale agreement also required the new employer which was already a Medicare contractor to attempt to value and budget the funded past service costs in their normal post-retirement medical valuation process creating legitimate future amortized program cost claims IF the government was not going to reimburse the initial funding as part of the contract termination final filings by Texas. BCBSSC has not filed any related cost amortizations and may not have the budget room to do so, and may be facing future program budgetary changes that may preclude them from being able to do that. BCBSTX/HCSC one might say continued to "do the right thing" when it funded these costs in an effort to support the transition of the employees and the stability of the program. BCBSTX would have in the long run if it had stayed in the contract presumably continued these benefits and charged the program on a cash basis over time for these same related costs. BCBSTX/HCSC has made reasonable attempts to recover these costs under avenues that applied to it as a Medicare program contractor. BCBSTX has no other direct method for future reimbursement from the government since it is no longer a Medicare contractor, except through the audit review/settlement process. BCBSTX/HCSC it seems after discussion with BCBSSC again finally recently (due to this audit result) may not have BCBSSC as a reasonable resource for reimbursement of these costs. HCSC does not find the finding as stated in the audit draft as acceptable. HCSC does have (and did furnish detail actuarial calculation files supporting this funded cost) and can supply any further information needed with dual actuarial firm support. HCSC prefers not to withdraw the basis for the claim of these costs. HCSC appeals to the governmental agencies that issue the audits, review the audits, and consider settlements to reconsider recognition of these reasonable legitimate costs associated with audit draft #3.

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Based on this collective response we propose the following related to finalization, closure and settlement of these audits and will act promptly upon issuance of final audit reports or agreements reflecting the above, the same, and the below. We will work with the OIG or other agencies on any additional reasonable information needed to consider this.

Audit draft #1 HCSC recognizes in excess pension plan assets at a point--- $11,152,093.
Audit draft #2 HCSC rests on its allocated and filed pension costs----------$-0-
Audit draft #3 HCSC splits the funded costs with the government
and will advise BCBSSC not to attempt claims
of these related reimbursed costs in the future --------$ (2,579,866)
Total from HCSC to Federal Government as full/final settlement----------$ 8,572,227

Please let us know when you have reviewed and considered these responses. If you have any questions we will assist. When you issue your final reply or your final reports we will promptly reply further.

Thank you and your staff again for your time, patience, professionalism, and consideration. Please send any reply or questions to Gene George (address below)(972-766-6192)(email Gene_George@bcbstx.com) who coordinated the audit activity from an operational/historical standpoint so those may be expedited as necessary internally.

Cordially,

Gene George
Senior Director, Treasury Division
Health Care Service Corporation
BCBSTX-3-E-W
901 S. Central Expressway
Richardson, Texas 75080

Cc Susan E. Gajda, Vice President
Audit and Performance Services
Health Care Service Corporation
11th Floor
300 East Randolph
Chicago, Illinois 60601-5099

Attachments OIG audit draft copies