DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

AUG - 5 2009

TO: Charlene Frizzera
Acting Administrator
Centers for Medicare & Medicaid Services

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

SUBJECT: Review of Termination Claim for Postretirement Benefit Costs Made by Blue Cross Blue Shield of Kansas (A-07-09-00310)

Attached is an advance copy of our final report on the termination claim for postretirement benefit (PRB) costs made by Blue Cross Blue Shield of Kansas (Kansas). We will issue this report to Kansas within 5 business days.

Kansas administered Medicare Part A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until the contractual relationship was terminated effective February 29, 2008. Throughout the period of its Medicare contracts, Kansas accounted for PRB costs using the pay-as-you-go method.

CMS reimburses a portion of its contractors' PRB costs. In claiming PRB costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation and applicable Cost Accounting Standards as required by their Medicare contracts. On February 26, 2008, Kansas submitted a termination claim of $11,200,000 to seek reimbursement for future PRB costs that it had not incurred prior to the termination of the Medicare contracts.

Our objective was to determine whether Kansas's termination claim for PRB costs associated with Medicare Part A and B contracts was allowable for Medicare reimbursement.

Kansas's entire termination claim of $11,200,000 in PRB costs for the Medicare Part A and B contracts was unallowable for Medicare reimbursement. The termination claim was calculated based on a retroactive change in accounting practice without CMS approval. Therefore, and pursuant to Kansas's Medicare contracts, none of the costs claimed were allowable.

We recommend that Kansas withdraw its termination claim of $11,200,000 for PRB costs associated with Medicare Part A and B contracts.

In written comments on our draft report, Kansas did not agree with our finding or recommendation. Kansas did not provide any additional information that would cause us to revise our finding or recommendation. We maintain that Kansas should withdraw the full claim amount.

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 through email at George.Reeb@oig.hhs.gov or Patrick J. Cogley, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591 or through email at Patrick.Cogley@oig.hhs.gov. Please refer to report number A-07-09-00310.

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

AUG - 7 2009

Report Number: A-07-09-00310

Mr. Ron Simmons
Controller
Blue Cross Blue Shield of Kansas
1133 SW Topeka Boulevard
Topeka, Kansas 66612

Dear Mr. Simmons:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of Termination Claim for Postretirement Benefit Costs Made by Blue Cross Blue Shield of Kansas." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

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

Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, OIG reports generally are made available to the public to the extent that information in the report is not subject to exemptions in the Act. Accordingly, this report will be posted on the Internet at http://oig.hhs.gov.

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through email at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-09-00310 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Ms. Deborah Taylor
Acting Director
Office of Financial Management
Centers for Medicare & Medicaid Services
Mail Stop C3-01-24
7500 Security Boulevard
Baltimore, Maryland 21244-1850

Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

REVIEW OF TERMINATION CLAIM FOR POSTRETIREMENT BENEFIT COSTS MADE BY BLUE CROSS BLUE SHIELD OF KANSAS

Daniel R. Levinson
Inspector General

August 2009
A-07-09-00310

Office of Inspector General

http://oig.hhs.gov

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

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

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

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
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Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, Office of Inspector General reports generally are made available to the public to the extent that information in the report is not subject to exemptions in the Act.

OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

Blue Cross Blue Shield of Kansas (Kansas) administered Medicare Part A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until the contractual relationship was terminated effective February 29, 2008. Throughout the period of its Medicare contracts, Kansas accounted for postretirement benefit (PRB) costs using the pay-as-you-go method.

CMS reimburses a portion of its contractors' PRB costs. In claiming PRB costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation and applicable Cost Accounting Standards as required by their Medicare contracts. On February 26, 2008, Kansas submitted a termination claim of $11,200,000 to seek reimbursement for future PRB costs that it had not incurred prior to the termination of the Medicare contracts.

OBJECTIVE

Our objective was to determine whether Kansas's termination claim for PRB costs associated with Medicare Part A and B contracts was allowable for Medicare reimbursement.

SUMMARY OF FINDING

Kansas's entire termination claim of $11,200,000 in PRB costs for the Medicare Part A and B contracts was unallowable for Medicare reimbursement. The termination claim was calculated based on a retroactive change in accounting practice without CMS approval. Therefore, and pursuant to Kansas's Medicare contracts, none of the costs claimed were allowable.

RECOMMENDATION

We recommend that Kansas withdraw its termination claim of $11,200,000 for PRB costs associated with Medicare Part A and B contracts.

AUDITEE COMMENTS

In written comments on our draft report, Kansas did not agree with our finding or recommendation. Kansas acknowledged that it had changed its accounting practice but did not address the fact that it had not obtained CMS approval to do so.

Kansas's comments are included in their entirety as the Appendix.

OFFICE OF INSPECTOR GENERAL RESPONSE

Kansas did not provide any additional information that would cause us to revise our finding or recommendation. We maintain that Kansas should withdraw the full claim amount.

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INTRODUCTION

BACKGROUND

Blue Cross Blue Shield of Kansas (Kansas) administered Medicare Part A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until the contractual relationship was terminated and operations ceased effective February 29, 2008. Throughout the period of its Medicare contracts, Kansas accounted for the postretirement benefit (PRB) costs associated with Medicare Part A and B contracts using the pay-as-you-go method.

CMS reimburses a portion of its contractors' PRB costs. In claiming PRB costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and applicable Cost Accounting Standards as required by their Medicare contracts.

The Medicare contracts require that costs be estimated (budgeted), accumulated, and reported on a consistent basis and that any change in accounting practice be submitted to CMS in advance for approval. Furthermore, the FAR sets forth the allowability requirements and the three methods of accounting for PRB costs that are permitted under a Government contract.

On February 26, 2008, Kansas submitted a termination claim of $11,200,000 to seek reimbursement for future PRB costs that it had not incurred prior to the termination of the Medicare contracts.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether Kansas's termination claim for PRB costs associated with Medicare Part A and B contracts was allowable for Medicare reimbursement.

Scope

At the request of CMS, we audited the PRB termination claim of $11,200,000 that Kansas submitted for the Medicare Part A and B contracts' PRB costs. Achieving our objective did not require that we review Kansas's overall internal control structure. However, we reviewed the internal controls related to the PRB termination claim to determine whether the claim was allowable in accordance with the FAR and the Medicare contracts.

Methodology

We examined Kansas's PRB claim in relation to applicable laws, regulations, and other Federal requirements. We also reviewed information presented in Kansas's termination claim, which included support provided by Kansas.

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 finding and conclusions based on our audit objective.

FINDING AND RECOMMENDATION

Kansas's entire termination claim of $11,200,000 in PRB costs for the Medicare Part A and B contracts was unallowable for Medicare reimbursement. The termination claim was calculated based on a retroactive change in accounting practice without CMS approval. Therefore, and pursuant to Kansas's Medicare contracts, none of the costs claimed were allowable.

FEDERAL REQUIREMENTS

FAR 31.205-6(o) sets forth the requirements and applicable methods of accounting for PRB costs under a Government contract. PRB costs may include, but are not limited to, postretirement health care; life insurance provided outside a pension plan; and other welfare benefits, such as tuition assistance, daycare, legal services, and housing subsidies provided after retirement. PRB costs do not include retirement income and ancillary benefits, such as life insurance, that pension plans pay following employees' retirement.

FAR 31.205-6(o)(2) requires contractors to use one of three methods for measuring and assigning PRB costs to accounting periods:

- The cash basis (or pay-as-you-go) method recognizes PRB costs when they are paid.

- The terminal funding method recognizes the entire PRB liability as a lump-sum payment upon termination of employees. The lump-sum payment must be remitted to an insurer or trustee for the purpose of providing PRBs to retirees and is allowable if amortized over 15 years.

- The accrual method measures and assigns costs according to generally accepted accounting principles and pays costs to an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRBs to retirees. The accrual must be calculated in accordance with generally accepted actuarial principles and practices as promulgated by the Actuarial Standards Board.

The Medicare contract, Appendix B, section II(A), requires that costs be estimated (budgeted), accumulated, and reported on a consistent basis. In addition, CMS issued to Medicare contractors the "Budget and Performance Requirements" (BPR), section VI(B), which states that "as regards the allocation of such costs to the Medicare contract/agreement . . . [a]ny change in accounting practice for such pension and/or post-retirement benefit costs <u>must be submitted to CMS in advance</u> for approval." The BPR further defines a change in accounting practice to include “a change from cash (pay-as-you-go) accounting to accrual accounting . . . .” In response to our prior reviews of PRB termination claims, CMS agreed that the Medicare contracts do not permit retroactive changes in accounting practices without advance CMS approval; accordingly, CMS issued cost disallowances on that basis.

UNALLOWABLE TERMINATION CLAIM

Kansas’s contractual relationship with CMS was terminated on February 29, 2008. On February 26, 2008, Kansas submitted a termination claim of $11,200,000 to seek reimbursement for future PRB costs that Kansas had not recognized prior to the termination of the Medicare contracts.

Throughout the entire period of its Medicare contracts, Kansas claimed PRB costs for the Medicare Part A and B contracts using the pay-as-you-go method. By selecting this method, Kansas signified that, pursuant to the FAR and its Medicare contracts, it would be reimbursed only for actual paid claims during each year.

Kansas based its termination claim for PRB costs on a retroactive change in its contract cost accounting practice from the pay-as-you-go method to the accrual method. Kansas did not obtain CMS approval before making this change, as required by the BPR. Therefore, Kansas’s claimed reimbursement for $11,200,000 in PRB costs was unallowable.

RECOMMENDATION

We recommend that Kansas withdraw its termination claim of $11,200,000 for PRB costs associated with Medicare Part A and B contracts.

AUDITEE COMMENTS

In written comments on our draft report, Kansas did not agree with our finding or recommendation. Nevertheless, Kansas acknowledged that it used the pay-as-you-go method during the contract period and that it used the accrual method to calculate its termination claim. Kansas did not address the fact that it had not obtained CMS approval before changing its accounting practice.

Kansas’s comments are included in their entirety as the Appendix.

OFFICE OF INSPECTOR GENERAL RESPONSE

Kansas did not provide any additional information that would cause us to revise our finding or recommendation. We maintain that Kansas should withdraw the full claim amount.

APPENDIX

BlueCross BlueShield of Kansas

1133 SW Topeka Boulevard
Topeka, Kansas 66629-0001

Web site: www.bcbsks.com

In Topeka - (785) 291-7000
In Kansas - (800) 432-0216

May 18, 2009

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

Dear Mr. Cogley,

This letter sets out the response of Blue Cross & Blue Shield of Kansas (BCBSKS) to the April 20, 2009 draft Office of Inspector General Report entitled "Review of Termination Claim for Post Retirement Benefit Costs Claimed by Blue Cross Blue Shield of Kansas" (Report Number A-09-00310). ("draft report" or "report")

We do not agree with the findings stated in the report that our claim for costs of Post Retirement Benefits ("PRBs") is unallowable, as is discussed further below.

BCBSKS has an obligation to pay PRBs subsequent to the termination of its Medicare contracts valued at $11,200,000 for employees dedicated to the performance of its Medicare Part A Intermediary and Medicare Part B Carrier contracts. Pursuant to Financial Accounting Standard 106, BCBKS has recognized this obligation by accruing and recording it in its full amount in the books and records of the company In this regard, a significant portion of this obligation will be paid to Medicare retirees during the period pending resolution of these termination proceedings .

BCBSKS' election to use the "pay as you go" approach during the period of contract performance for claiming the costs of PRBs for Medicare employees does not serve to delete the provision in the Intermediary and Carrier contracts that, "*..the Intermediary [or Carrier], in performing its functions under this [Intermediary] agreement [or Carrier contract] shall be paid its costs of administration under the principle of neither profit nor loss ...*" This provision implements requirements of the statutory provisions authorizing Intermediary and Carrier contracts, respectively, 42 U.S.C.§1395u(c)(1) and 42. U.S.C. §1395h(c)(1).[1] The disallowances of the above costs of Post Retirement Benefits that BCBSKS is

1 Both provisions state in relevant part:

> *Any contract entered into with a carrier [an intermediary] under this section ...shall provide for payment of the costs of administration of the carrier [intermediary], as determined by the Secretary to be necessary and proper...The Secretary shall provide that in determining a carrier's [intermediary's] necessary and proper cost of administration, the Secretary shall, with respect to each contract, take into account the amount that is*

(footnote continued)

May 18, 2009
Mr. Patrick Cogley
Office of Inspector General

obligated to pay will result in a loss to the company in the amount of the obligation. The disallowance is inappropriate because it is not in accordance with the above statute-based provisions of the contracts which are central to the principle purpose of Carrier and Intermediary contracts as mandated by Congress, i.e., the administration of the Medicare program through contracts that limit government payments to contractors to reimbursement of their costs of administering Medicare Parts A and B.

We note that you rely on the concept of "change in accounting practice" as a basis for disallowance of the company's PRB costs. Such reliance is misplaced. We understand that CMS attempted to obviate the effect of the 1990 issuance of FAS 106 by using the 1993 Budget and Performance Requirements (BPRs) to incorporate the concept of "change in accounting practice" into Carrier and Intermediary contracts. But that concept is based on and defined in the Cost Accounting Standards (CAS) at FAR Appendix Section 9903.302-1 and, in contrast to its mandate that Carriers and Intermediaries be paid only their "costs of administration," i.e., be performed without loss or gain to the contractor, Congress has never indicated that the CAS are required elements of Medicare Intermediary and Carrier contracts

In these circumstances CMS's insertion of a CAS concept into the BPRs cannot trump the statutorily based requirement that the contracts be performed "under the principle of neither profit nor loss to the [contractor]…" which, consistent with Congressional intent as explicitly expressed in the authorizing statute, has been a part of these contracts since commencement of the Medicare program in 1965. Stated otherwise, CMS' action cannot change the fundamental nature of these agreements as mandated by Congress. . "[T]he rule for …[CMS}, like private parties, sometimes is *pacta sunt servanda*-colloquially, 'a deal is a deal.' (citations omitted.) *Franconia Associates v. U.S.*, 461 Fed.Cl. 718, 751 (2004)

BCBSKS explicitly disagrees with the OIG's recommendation that it withdraw its claim of $11,200,000 for PRB costs and maintains the claim in connection with the termination proceedings for the subject contracts and reserves all legal and equitable arguments available to it regarding this matter.

Sincerely,

Ronald D. Simmons
Controller

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reasonable and adequate to meet the costs which must be incurred by an efficiently and economically operated carrier [intermediary] in carrying out the terms of its contract.

42 U.S.C.§1395u(c)(1) and 42. U.S.C. §1395h(c)(1