



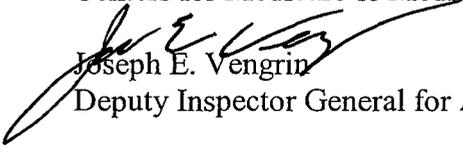
DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

OCT 19 2006

TO: Leslie V. Norwalk, Esq.
Acting Administrator
Centers for Medicare & Medicaid Services

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

SUBJECT: Review of Postretirement Benefit Costs Claimed by Blue Cross Blue Shield of Rhode Island (A-07-06-00210)

Attached is an advance copy of our final report on Blue Cross Blue Shield of Rhode Island's (Rhode Island) claim for postretirement benefit (PRB) costs subsequent to its contract termination. We will issue this report to Rhode Island within 5 business days.

Rhode Island administered Medicare Parts A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services until the contractual relationship was terminated effective February 1, 2004. Federal regulations and the Medicare contracts provide guidance for claiming PRB costs.

Our objective was to determine whether PRB costs claimed for the period subsequent to Rhode Island's termination were allowable for Medicare reimbursement.

Rhode Island's entire claim of \$3,558,976 in PRB costs was unallowable for Medicare reimbursement. The claim represented (1) a retroactive change in accounting basis, (2) an immediate recognition of the transition obligation, and (3) a request for reimbursement of unfunded costs. None of these costs are allowable in accordance with the Federal Acquisition Regulation (FAR); therefore, the costs were unallowable for Medicare reimbursement.

We recommend that Rhode Island withdraw its claim of \$3,558,976 for PRB costs.

Rhode Island disagreed with our recommendation. Rhode Island stated that the PRB obligation was incurred and recorded on the books of the company pursuant to Statement of Financial Accounting Standards 106. In addition, Rhode Island said that it had paid a portion of the obligation since the date of termination and had recorded the costs in the years that they were incurred.

Rhode Island agreed that it elected to claim PRB costs on a pay-as-you-go basis during the performance of the Medicare contract. However, it stated that a contract provision required that the Medicare contract be performed with no gain or loss to the contractor.

We continue to believe that our recommendation is valid because the claim is not allowable under the FAR.

Page 2 – Leslie V. Norwalk, Esq.

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 Patrick J. Cogley, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591. Please refer to report number A-07-06-00210 in all correspondence.

Attachment



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

OCT 24 2006

Report Number: A-07-06-00210

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

Mr. David F. Fogerty, Jr.
Director, Budgets & Cost Analysis
Blue Cross Blue Shield of Rhode Island
444 Westminster Street
Providence, Rhode Island 02903

Dear Mr. Fogerty:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Postretirement Benefit Costs Claimed by Blue Cross Blue Shield of Rhode Island." A copy of this report will be forwarded to the HHS action official noted on the next page for review and any action deemed necessary.

The HHS action official will make final determination regarding actions taken on all matters reported. We request that you respond to the HHS 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 the 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).

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, extension 274, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21 or through e-mail at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-06-00210 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Ms. Charlotte Yeh
Regional Administrator, Region I
Centers for Medicare & Medicaid Services
JFK Federal Building
Room 2325
Boston, Massachusetts 02203

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF POSTRETIREMENT
BENEFIT COSTS CLAIMED BY
BLUE CROSS BLUE SHIELD OF
RHODE ISLAND**



Daniel R. Levinson
Inspector General

October 2006
A-07-06-00210

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:

Office of Audit Services

The 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. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

Office of Evaluation and Inspections

The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. Specifically, these evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness in departmental programs. To promote impact, the reports also present practical recommendations for improving program operations.

Office of Investigations

The Office of Investigations (OI) conducts criminal, civil, and administrative investigations of allegations of wrongdoing in HHS programs or to HHS beneficiaries and of unjust enrichment by providers. The investigative efforts of OI lead to criminal convictions, administrative sanctions, or civil monetary penalties.

Office of Counsel to the Inspector General

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. OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within HHS. OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops compliance program guidances, 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
at <http://oig.hhs.gov>

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 the information 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 HHS divisions will make final determination on these matters.



EXECUTIVE SUMMARY

BACKGROUND

Blue Cross Blue Shield of Rhode Island (Rhode Island) administered Medicare Parts A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until the contractual relationship was terminated effective February 1, 2004. Rhode Island 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 (FAR) and applicable Cost Accounting Standards as required by their Medicare contracts. Rhode Island submitted a \$3,558,976 claim for PRB costs to be incurred subsequent to the termination of the Medicare contract.

OBJECTIVE

Our objective was to determine whether PRB costs claimed for the period subsequent to Rhode Island's termination were allowable for Medicare reimbursement.

SUMMARY OF FINDING

Rhode Island's entire claim of \$3,558,976 in PRB costs was unallowable for Medicare reimbursement. The claim represented (1) a retroactive change in accounting basis, (2) an immediate recognition of the transition obligation, and (3) a request for reimbursement of unfunded costs. None of these costs are allowable in accordance with the FAR; therefore, the costs were unallowable for Medicare reimbursement.

RECOMMENDATION

We recommend that Rhode Island withdraw its claim of \$3,558,976 for PRB costs.

AUDITEE'S COMMENTS

Rhode Island stated that it “. . . explicitly disagrees with the OIG's recommendation that it withdraw its claim of \$3,558,976 for PRB costs”

Rhode Island stated that the PRB obligation was incurred and recorded on the books of the company pursuant to Statement of Financial Accounting Standards 106. In addition, Rhode Island said that it had paid a portion of the obligation since the date of termination and had recorded the costs in the years that they were incurred.

Rhode Island agreed that it elected to claim PRB costs on a pay-as-you-go basis during the performance of the Medicare contract. However, it stated that a contract provision required that the Medicare contract be performed with no gain or loss to the contractor. Rhode Island's comments are presented in their entirety in the Appendix.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We continue to believe that our recommendation is valid because the claim is not allowable under the FAR.

INTRODUCTION

BACKGROUND

Medicare

Blue Cross Blue Shield of Rhode Island (Rhode Island) administered Medicare Parts A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until the contractual relationship was terminated effective February 1, 2004. Rhode Island 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 (FAR) and applicable Cost Accounting Standards as required by their Medicare contracts.

Regulations

The FAR 31.205-6(o) sets forth the allowability 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, day care, legal services, and housing subsidies provided after retirement. PRBs do not cover retirement income and ancillary benefits, such as life insurance, that pension plans pay following employees' retirement.

In addition, FAR 31.205-6(o) requires contractors to choose one of three accounting practices (pay-as-you-go, accrual accounting, or terminal funding) for measuring and assigning PRB costs to accounting periods. The Medicare contract requires that costs be estimated (budgeted), accumulated, and reported on a consistent basis, and the Budget Performance Requirements require that any change in accounting practice for PRB costs must be submitted to CMS in advance for approval.

The FAR further states that to be allowable, costs must be funded by the time set for filing the Federal income tax return or any extension thereof. The PRB costs assigned to the current year, but not funded by the tax return time, are not allowable in any subsequent year.

In 1990, the issuance of the Statement of Financial Accounting Standards (SFAS) 106 mandated that contractors report in their financial statements the accrued liability for PRBs for current and retired employees and set forth specific guidance on the accrual methodology to be used. However, for Government contract purposes, the FAR allows contractors to continue to recognize PRB costs using the pay-as-you-go method or use the accrual accounting method following SFAS 106 methodology for funded PRBs. The FAR does not allow contractors to immediately recognize the SFAS 106 transition obligation (initial liability). Instead, the FAR requires recognition of the transition obligation on an amortized basis.

The Budget and Performance Requirements for fiscal year 1993 alerted Medicare contractors to the SFAS 106 requirements and the FAR options. Rhode Island chose to continue using the pay-

as-you-go method for its Government contracts and recognize PRB costs when they were actually provided.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether PRB costs claimed for the period subsequent to Rhode Island's termination were allowable for Medicare reimbursement.

Scope

At the request of CMS, we audited Rhode Island's August 31, 2004, claim of \$3,558,976 for PRB costs to be incurred subsequent to the termination of the Medicare contract. Achieving our objective did not require that we review Rhode Island's internal control structure.

Methodology

In performing our review, we used information presented in Rhode Island's Termination Cost Voucher, which included support provided by Rhode Island's consulting actuaries. We examined Rhode Island's PRB claim in relation to applicable laws and regulations to determine whether Rhode Island complied with regulatory requirements.

We conducted our review in accordance with generally accepted government auditing standards.

FINDING AND RECOMMENDATION

CLAIMED COSTS WERE UNALLOWABLE

Rhode Island's entire claim of \$3,558,976 in PRB costs was unallowable for Medicare reimbursement. The claim represented (1) a retroactive change in accounting basis, (2) an immediate recognition of the transition obligation, and (3) a request for reimbursement of unfunded costs. None of these costs are allowable in accordance with the FAR; therefore, the costs were unallowable for Medicare reimbursement.

Rhode Island's contractual relationship under Medicare was terminated on February 1, 2004. On August 31, 2004, Rhode Island claimed \$3,558,976 to cover PRBs to be paid subsequent to the contract completion date. Rhode Island's established cost accounting practice for Government contracts was to claim PRB costs using the pay-as-you-go method. On this basis, Rhode Island would have been reimbursed for actual PRB costs incurred through the contract termination date. Rhode Island's subsequent claim for PRB costs was calculated using the accrual method and considering the immediate recognition of the entire transition obligation amount.

The PRB claim was based on a retroactive change in contract cost accounting practice, from the pay-as-you-go method to the accrual accounting method, for claiming PRB costs subsequent to contract termination. In addition to being a retroactive change for which Rhode Island did not

seek prior CMS approval, the application of the SFAS 106 accrual accounting method for PRBs was not in compliance with the FAR with regard to treatment of a transition obligation. Furthermore, although Rhode Island's claim was based on the accrual method, Rhode Island had not established a fund or reserve to provide PRBs to retirees. Therefore, Rhode Island claimed reimbursement for unfunded costs.

RECOMMENDATION

We recommend that Rhode Island withdraw its claim of \$3,558,976 for PRB costs.

AUDITEE'S COMMENTS

Rhode Island stated that it “. . . explicitly disagrees with the OIG's recommendation that it withdraw its claim of \$3,558,976 for PRB costs”

Rhode Island stated that the PRB obligation was incurred and recorded on the books of the company pursuant to SFAS 106. In addition, Rhode Island said that it had paid a portion of the obligation since the date of termination and had recorded the costs in the years that they were incurred.

Rhode Island agreed that it elected to claim PRB costs on a pay-as-you-go basis during the performance of the Medicare contract. However, it stated that a contract provision required that the Medicare contract be performed with no gain or loss to the contractor. Rhode Island's comments are presented in their entirety in the Appendix.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

The Medicare contract requires that costs claimed for Medicare reimbursement be allowable and allocable in accordance with the FAR. Moreover, Rhode Island provided no additional documentation to show that it had established a trust fund for the PRB costs. Therefore, our position has not changed; Rhode Island should withdraw its claim because it represents a retroactive change in accounting basis, an immediate recognition of the transition obligation, and a request for reimbursement of unfunded costs, which are unallowable in accordance with the FAR.

APPENDIX



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,

Please consider this correspondence to be Blue Cross & Blue Shield of Rhode Islands (BCBSRI) response to the Office of Inspector General Report entitled "Review of Post Retirement Benefit Costs Claimed by Blue Cross Blue Shield of Rhode Island" (Report Number A-07-06-00210).

We do not agree with the findings in this report that our Medicare Claim was unallowable for the following reasons.

BCBSRI has an obligation to pay Post Retirement Benefits subsequent to the termination of its Medicare contracts valued at \$3,558,976 for employees dedicated to the performance of those contracts. The obligation has been incurred and recorded on the books and records of the company pursuant to Financial Accounting Standard 106. In this regard, a portion of this obligation has been paid since the date of termination. These costs have been recorded on the books and records of the company in the years in which they were incurred.

BCBSRI's election to use the "pay as you go" approach for filing Medicare expenses during performance does not obviate the explicit contract provision that Medicare contracts be performed with neither loss nor gain to the contractor. The disallowance of the above costs of Post Retirement Benefits that BCBSRI is obligated to pay will result in a loss to the company in the amount of the obligation. The disallowance is therefore inappropriate because it is not in accordance with the contract.

BCBSRI explicitly disagrees with the OIG's recommendation that it withdraw its claim of \$3,558,976 for PRB costs and maintains the claim in connection with the termination proceedings for the subject contracts.

Please call me at (401) 459-1956 if you have any questions regarding this response.

Sincerely,

David F. Fogerty, Jr.
Assistant Vice President-Financial Planning