



SEP 15 2003

Office of Audit Services  
Region I  
John F. Kennedy Federal Building  
Boston, MA 02203  
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Report Number: A-01-02-00527

Karen Pelliccia  
Director of Budget and Reporting  
Anthem Blue Cross and Blue Shield of Connecticut  
370 Bassett Road  
North Haven, Connecticut 06473

Dear Ms. Pelliccia:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General, Office of Audit Services' report entitled, "Review of Anthem Blue Cross Blue Shield of Connecticut Medicare Contract Termination and Severance Costs." A copy of this report will be forwarded to the action official noted below for review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. 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.

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To facilitate identification, please refer to report number A-01-02-00527 in any correspondence relating to this report.

Sincerely yours,

Michael J. Armstrong  
Regional Inspector General  
For Audit Services

Enclosures – as stated

**Direct Reply to HHS Action Official:**

Charlotte Yeh, M.D.  
Regional Administrator  
Centers for Medicare and Medicaid Services – Region I  
Room 2325, JFK Federal Building  
Boston, Massachusetts 02203

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF ANTHEM BLUE CROSS  
BLUE SHIELD OF CONNECTICUT  
MEDICARE CONTRACT  
TERMINATION AND SEVERANCE  
COSTS**



**SEPTEMBER 2003**

**A-01-02-00527**

# *Office of Inspector General*

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## **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**

The Centers for Medicare and Medicaid Services (CMS) contracted with Anthem Blue Cross and Blue Shield of Connecticut to process Part A Medicare claims in the state of Connecticut. However, in accordance with the Medicare contract, Anthem informed CMS on January 11, 1999, that it did not intend to renew its Medicare contract. The CMS agreed to reimburse Anthem for all allocable and reasonable termination and severance costs incurred in closing out the Medicare contract. Anthem completed the transfer of responsibilities to the new successor contractor, terminating its Medicare contract, as of June 30, 1999.

### **OBJECTIVE**

The purpose of the review was to determine if Anthem's claim for termination and severance costs related to the Medicare contract termination represented allowable, allocable and reasonable costs under the provisions of applicable Federal regulations, the Medicare contract, CMS instructions, and Anthem company policies.

### **RESULTS OF REVIEW**

Anthem claimed \$518,049 for contract termination costs. These costs included \$420,481 in severance costs and \$97,568 in termination expenses. Based on our review, we determined that \$104,030 in severance costs and \$438 in termination expenses were not allowable for Medicare reimbursement.

The unallowable severance costs included:

- \$72,102 related to excess severance costs based on non-Medicare years of service;
- \$25,765 related to four employees who refused employment offers with the successor contractor; and
- \$6,163 calculated in excess of Anthem's company severance policy.

The unallowable termination costs of \$438 were related to clerical errors.

### **RECOMMENDATION**

We recommend disallowance of the \$104,030 in severance costs and the \$438 in termination costs.

In a written response to our draft report dated August 25, 2003 (see APPENDIX B), Anthem officials agreed with the recommend disallowances for severance payments of

\$6,163 that were in excess of Anthem's company severance policy and the \$438 in clerical errors related to termination costs. However, Anthem officials did not agree with our recommended adjustments related to severance payments of \$72,102 based on non-Medicare years of service or the severance payments of \$25,765 for the Medicare employees who refused employment offers with the successor contractor.

The CMS instructions provided to Anthem specified that these types of severance costs were not allowable for Medicare reimbursement. Accordingly, we believe that our recommended adjustments totaling \$97,867 related to these issues are valid.

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# **INTRODUCTION**

## **BACKGROUND**

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled (Medicare) program. Part A of the program is the hospital insurance program and provides coverage related to the cost of inpatient hospital care, post-hospital extended care, and post-hospital home health care. The Centers for Medicare and Medicaid Services (CMS) administers the Medicare program by contracting with private organizations to process and pay claims for services provided to eligible beneficiaries.

The CMS contracted with Anthem Blue Cross and Blue Shield of Connecticut (Anthem) to process Part A claims submitted by certain hospitals and other medical suppliers in the state of Connecticut. In accordance with provisions of the Medicare contract, Anthem informed CMS on January 11, 1999, that it did not intend to renew its Part A contract. Anthem and CMS agreed to cooperate fully in the transfer of responsibilities to a new contractor. The transfer was completed on June 30, 1999.

As part of Anthem's termination from the Medicare program, CMS agreed to reimburse Anthem for reasonable, allowable, and allocable termination costs incurred in transferring responsibilities to other contractors and for allowable severance costs. All such costs were required to be claimed in accordance with applicable Federal Acquisition Regulations (FAR), provisions of the contract, CMS instructions, and Anthem's established written Severance Pay Plan.

Anthem claimed total termination expenses of \$518,049, including \$97,568 for contract termination expenses and \$420,481 for severance costs. Anthem originally submitted schedules to CMS claiming their severance costs. However, CMS has not reimbursed Anthem for these or any other costs related to the termination process. Anthem provided us with schedules detailing their claim for all termination and severance costs as well as documentation to support these costs.

## **OBJECTIVE, SCOPE AND METHODOLOGY**

The objective of our review was to determine if the termination and severance costs claimed for reimbursement represented allowable, allocable, and reasonable costs under the provisions of applicable FARs, Medicare contract provisions, CMS instructions, and Anthem's company severance policies. The audit was conducted in accordance with generally accepted government auditing standards.

In performing our review, we examined the \$518,049 Anthem claimed for the termination process; \$97,568 related to termination costs and \$420,481 related to severance costs. These costs represent the entire amount that Anthem is claiming for the termination process.

To accomplish our objective, we utilized applicable Federal regulations, Medicare contract provisions, CMS instructions, and Anthem company severance policies to determine if the amounts claimed met reimbursement requirements. We also discussed the objectives of our

review with CMS Headquarters and Regional Office officials to identify any other requirements placed on contractors by CMS. We examined supporting expense reports, payroll reports, and personnel records to (1) perform detailed audit tests of various cost categories, (2) determine the eligibility of terminated employees for severance benefits and (3) determine the accuracy of Anthem's calculations for termination and severance costs. In this regard, we interviewed Anthem officials to determine the methods used in calculating some claimed costs, which according to our analysis, did not meet reimbursement requirements.

We limited our testing to termination and severance costs charged and listed on summaries provided by Anthem officials. We also determined that none of these costs were included in the June 30, 1999 Final Administrative Cost Proposal, the last one filed by Anthem.

Our fieldwork was performed at the Anthem corporate offices in North Haven, Connecticut and at the Hartford, Connecticut Field Office of the Office of Inspector General, Office of Audit Services during the period July 2002 through May 2003.

Anthem's response to our draft report is appended to this report in its entirety in APPENDIX B.

## **FINDINGS AND RECOMMENDATIONS**

Our review disclosed that Anthem claimed total contract termination costs of \$518,049. Based on our review, we determined that \$104,030 claimed for severance costs and \$438 claimed for termination costs are unallowable for Medicare reimbursement. The following provides details relative to unallowable costs.

### **SEVERANCE COSTS**

We found that \$104,030 of the \$420,481 claimed for severance costs were unallowable for Medicare reimbursement because they were not calculated in accordance with applicable Federal regulations, CMS instructions, and Anthem's company severance policy. These costs included:

- \$72,102 related to severance costs calculated based on non-Medicare years of service;
- \$25,765 for four employees who refused jobs with Empire Blue Cross and Blue Shield (Empire) – the successor contractor; and
- \$6,163 calculated in excess of Anthem's Severance Pay Plan guidelines.

### **Severance Costs Based On Non-Medicare Years Of Service**

We found that Anthem's claim for severance reimbursement for all employees was based on the total years of an employee's service with Anthem. However, we noted that some of these employees had worked for Anthem's private lines of business as well as Medicare and, therefore, their severance was based on a combination of Medicare and non-Medicare years of service. We believe that this provides an inequitable allocation of costs to Medicare.

Regarding allocability of costs to the Federal government, FAR 31.201- 4 states that:

“...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...a costs is allocable to a Government contract if it...(b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received...”

We also noted that CMS instructed Anthem to allocate severance costs based on Medicare years of service. The CMS instructions, per the CMS Bureau of Program Operations memorandum dated February 18, 1997, indicated that Medicare will not reimburse Anthem for non-Medicare years of service. Specifically, this instruction limits Medicare reimbursement for severance pay:

“...in proportion to the time each employee worked in the Medicare program.”

Finally, Appendix B, Section XV. A. of the Medicare contract identifies as unallowable:

“...costs, which relate to the contractor’s non-Medicare business and do not contribute to the Medicare agreement/contract.”

Based on the criteria and CMS instructions cited above, we believe that the severance cost charged to Medicare should be based only on those years that the employee worked in Anthem’s Medicare line of business. The remainder of the severance should be charged to Anthem’s private lines of business, as appropriate. As a result, severance costs claimed by Anthem were overstated by \$72,102.

### **Severance Costs for Employees Who Refused Employment Offers With Successor Contractor**

Empire, the successor Medicare contractor, offered jobs to selected Anthem employees. Instructions provided to all Medicare contractors by CMS (formerly Health Care Financing Administration) Headquarters in a memorandum dated May 21, 1999 indicated that:

“Severance pay will not be paid to employees who have been hired by the incoming contractor...or who have received a written offer of employment by the incoming contractor and have chosen to refuse that employment.”

In addition, we noted several other communications between CMS and Anthem that addressed the same issue. In all cases, CMS’ guidance indicated that severance would not be paid for employees who refuse employment offers with the successor contractor.

We found that four employees who were offered employment by Empire refused the offers. However, Anthem paid them a total of \$25,765 in severance payments and claimed these costs for Medicare reimbursement.

Based on the CMS instructions noted above, we believe that Anthem’s claim for severance payments to the employees who refused employment offers with Empire are not allowable for

Medicare reimbursement. Therefore, the severance costs are overstated by \$25,765.

### **Severance Costs In Excess of Anthem’s Severance Pay Plan**

We determined that Anthem claimed costs of \$6,163 for severance payments in excess of the allowable number of severance weeks per Anthem’s company-wide Severance Pay Plan guidelines, dated September 1, 1999. In this regard, the CMS Memorandum of May 21, 1999 states that the contractor will be reimbursed for severance payments under the following conditions:

“The contractor shall have an established, written severance policy in place and it must be found to be reasonable by the Government.”

### **RECOMMENDATION**

We recommend disallowance of Anthem’s claim for reimbursement of \$104,030 for severance costs, consisting of \$72,102 for severance costs for non-Medicare years of service, \$25,765 for severance payments made to employees who refused offers of employment from the successor Medicare contractor and \$6,163 for severance payments that were in excess of the allowable number of severance weeks per Anthem’s company severance policy.

### **TERMINATION COSTS**

We found that \$438 of the \$97,568 in termination costs claimed are not acceptable because of clerical discrepancies in posting amounts used to support the charges. Our review identified minor clerical errors while posting salary amounts from the payroll registers onto the supporting summary schedule, resulting in overstatement of the salary amounts claimed. These costs were related to employees who were involved in the final termination process. The costs include \$407 in salaries and \$31 in social security taxes.

### **RECOMMENDATION**

We recommend disallowance of the \$438 in termination costs based on clerical discrepancies.

### **ANTHEM’S COMMENTS AND OIG’S RESPONSE**

In a written response to our draft report dated August 25, 2003 (See APPENDIX B), Anthem officials agreed with our disallowance of \$6,163 associated with minor errors in computing the allowable number of severance weeks and \$438 related to clerical errors in the calculation of the termination costs. However, Anthem officials did not agree with our recommended adjustments for severance costs of \$72,102 for non-Medicare years of service and \$25,765 paid to employees who refused offers of employment from the successor Medicare contractor. The following provides a summary of Anthem’s comments and the OIG additional response on these issues.

## **Severance Costs Based On Non-Medicare Years Of Service**

### **Anthem Comments**

The Anthem response notes that they previously presented their position on this issue to CMS. In this regard, Anthem indicated that it has consistently implemented the practice that an employee's employment responsibility at the time of severance determines the line of business to which the employee's severance costs are allocated. As a result, Anthem maintains they are entitled to full Medicare reimbursement for all severance payments made to employees who were employed in the Medicare line of business at the time of termination from the program. As such, this includes that portion of their severance related to years of service those employees worked on the private lines of business prior to joining the Medicare segment.

The response states that CMS has avoided paying for severance costs of former Anthem employees who had worked in Medicare but at the time of severance from Anthem were employed in non-Medicare lines of business. In addition, Anthem officials believe that the government will avoid its share of any future severance costs that may be paid to current Anthem employees who may be terminated at some future date and had previous Medicare years of service.

### **OIG Response**

As noted in our report, CMS' instruction dated February 18, 1997, specifically limits severance costs claimed by Medicare contractors to only that portion related to the time each employee worked in the Medicare program. The CMS has consistently maintained the position that severance payments computed in any other manner are not allowable. In previous correspondence between CMS and Anthem, CMS requested examples of terminated employees for whom Anthem did not previously allocate severance costs to the Medicare contract, based upon Medicare years of service, when such employees were terminated while working in a non-Medicare area of Anthem. However, Anthem has not provided such specific examples. Our report provided Anthem another opportunity to quantify the amount of any severance these dual service time employees may have received but no such information has been provided by Anthem.

Consequently, we maintain our recommended disallowance of \$72,102 is valid.

## **Severance Costs for Employees Who Refused Employment Offers With Successor Contractor**

### **Anthem Comments**

Anthem disagreed with our recommendation to disallow \$25,765 in severance payments to four Medicare employees who refused employment with the successor contractor. Anthem states the CMS memorandum dated May 21, 1999, referenced in our report, should not be applied to the terms of Anthem's severance plan, since Anthem's severance plan was communicated to its employees and to CMS prior to May 21, 1999. Anthem officials indicated that they have no

information about which employees might have received verbal or written offers of employment from the successor contractor as this type of information is generally considered private information.

The response also states that Anthem made severance payments in accordance with its severance plan then in effect. Anthem stated that our report appeared to give no regard to inherent critical employment decision-making factors such as proximity of the place of employment to the employee's current residence, salary, benefits or opportunity for advancement.

### **OIG Response**

Under the terms of the termination agreement, CMS agreed to reimburse Anthem for reasonable, allowable, and allocable termination costs incurred in transferring responsibilities to other contractors and for allowable severance costs. Such costs were to be in compliance with provisions of the FAR as well as CMS instructions and Anthem's established written Severance Pay Plan.

As noted in our report, CMS provided specific instructions to Anthem that those employees who refused employment offers from the successor contractor were not eligible for severance payments. This instruction has been a consistent policy of CMS used for other Medicare contractors that have terminated from the Medicare program. In this regard, we noted that the Health Care Financing Administration (predecessor to CMS) in 1997 instructed a Medicare contractor to not claim severance costs for employees who refused employment with the successor contractor when the contractor terminated from Medicare.

With respect to Anthem's company policies regarding severance payments, we noted that Anthem's Fairness and Policy Statement guidelines related to company severance payments indicate severance will not be offered if an employee's job is eliminated and the employee accepts any position with Anthem, or is offered and refused a comparable position, defined as a position with the same base pay, geographical locale (within 50 miles of the current work location) and similar work schedule. We believe that the employment offers from the successor contractor to the four employees met the standards of the Anthem Fairness and Policy Statement noted above as the employees were offered comparable positions in the same geographical area as Anthem. Therefore, we believe that severance should not have been claimed for these employees.

Finally, we noted that information relative to which Anthem employees that received employment offers from the successor contractor but refused was readily available from CMS. In fact, this was our source for review of this issue.

Based on the above, we believe that our recommended disallowance of \$25,765 is valid.

# **APPENDICES**

**APPENDIX A**

**ANTHEM BLUE CROSS AND BLUE SHIELD OF CONNECTICUT  
MEDICARE CONTRACT SEVERANCE AND TERMINATION COSTS**

<b><u>ELEMENTS OF EXPENSE</u></b>	<b><u>AMOUNT CLAIMED</u></b>	<b><u>RECOMMENDED FOR DISALLOWANCE</u></b>
<b>SEVERANCE PAYMENTS:</b>		
<b>SALARIES AND WAGES</b>	<b>\$369,597</b>	<b>\$ 96,849</b>
<b>PAYROLL TAX</b>	<b>26,835</b>	<b>7,181</b>
<b>PAID TIME OFF</b>	<b>24,049</b>	<b>-0-</b>
<b>TERMINATION EXPENSES:</b>		
<b>SALARIES AND WAGES</b>	<b>37,740</b>	<b>407</b>
<b>FRINGE BENEFITS</b>	<b>2,887</b>	<b>31</b>
<b>PROFESSIONAL SERVICES</b>	<b>41,271</b>	<b>-0-</b>
<b>CONTRACT SERVICES</b>	<b><u>15,669</u></b>	<b><u>-0-</u></b>
<b>TOTAL</b>	<b><u>\$518,048</u></b>	<b><u>\$104,468</u></b>



Anthem Blue Cross and Blue Shield  
370 Bassett Road  
North Haven, Connecticut 06473-4201  
203-239-4911



Appendix B  
Page 1 of 3

By Facsimile: (860) 240-4268

August 25, 2003

Robert Champagne, Audit Manager  
Department of Health & Human Services  
Office of Inspector General  
Office of Audit Services - Region I  
William R. Cotter Federal Building  
135 High Street  
Suite 274  
Hartford, CT 06103

**Re: Report Number A-01-02-00527  
Draft Audit Report**

Dear Mr. Champagne:

Anthem Blue Cross and Blue Shield ("Anthem") has reviewed the draft Audit Report entitled "Review of Anthem Blue Cross and Blue Shield of Connecticut Medicare Contract Termination and Severance Costs" dated June 26, 2003. Anthem appreciates this opportunity to submit its comments to the draft Report as follows.

### **TERMINATION COSTS**

The Report recommends disallowance of \$438 in termination costs based on clerical discrepancies. Anthem agrees with and accepts this recommendation.

### **SEVERANCE COSTS**

The Report divides the severance cost issues into three areas:

- Severance costs based on non-Medicare years of service
- Severance costs for employees who refused employment offers with the successor contractor
- Severance costs in excess of Anthem's severance pay plan.

With respect to the third bulleted item, Anthem agrees with and accepts the Report's recommendation of disallowance of \$6,163 for severance payments that were in excess of Anthem's company severance policy.

Robert Champagne, Audit Manager  
August 25, 2003  
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Anthem respectfully disagrees with the Report's recommendations related to the remaining two severance costs issues, for the reasons explained herein.

#### Severance Costs Based on Years of Service

The recommendation of the Report states that "the severance costs charged to Medicare should be based only on those years that the employee worked in Anthem's Medicare line of business. The remainder of the severance costs should be charged to Anthem's private lines of business as appropriate." Based on this recommendation, the Report claims that Anthem's severance costs were overstated by \$72,102.

As Anthem has previously presented in writing and verbally to CMS' Contracting Officer, Ms. Kathy Markman, the government's position, if followed, will require Anthem to keep its contract with CMS open for possible future allocation of severance costs for employees who may have, in the past, had Medicare years of service. Such a result seems clearly contradictory to the government's goal of final closure of all contract matters with contractors which have exited their contracting role.

Even now, Anthem continues to employ individuals who previously worked in the Medicare program. If Anthem adopted the Report's position, then CMS would avoid the severance costs related to non Medicare years of services stated in the Report *and* it would also avoid its share of any future severance paid to those current Anthem employees who have past Medicare years of service. Moreover, Anthem has consistently implemented the practice that an employee's employment responsibility at the time of severance determines the line of business, Medicare or non-Medicare, to which all of such severance costs are allocated. Consequently, CMS has avoided severance costs of former Anthem employees who, at the time of severance from Anthem, were employed in the non-Medicare line of business, but who nevertheless had Medicare years of service.

For these reasons, and in order to bring finality to the government's contract liability, Anthem respectfully submits that its position is proper. Anthem therefore disagrees with the recommendation stated in the Report.

#### Severance Costs for Employees Who Were Not Offered a Position by Anthem and Who Were not Employed by the Successor Contractor

The recommendation of the Report states that severance costs are overstated by \$25,765 because Anthem paid this severance to employees who refused employment offers with the successor contractor. In support of this recommendation, the Report references CMS'

Robert Champagne, Audit Manager  
August 25, 2003  
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memorandum dated May 21, 1999. Anthem respectfully points out that this Memorandum should not be applied to the terms of Anthem's severance plan, since Anthem's severance plan was communicated to its employees and to CMS prior to May 21, 1999.

It seems that the recommendation stated in the Report confounds American employment principles. Written offers of employment are generally considered private information. Even now, for example, Anthem has no information about which Anthem employees might have received verbal or written offers of employment from the successor contractor. Yet, the position stated in the Report suggests that Anthem *should* have this information. Further, the position would lead to a result that an employee who receives a verbal offer and rejects it before it is reduced to writing would receive severance yet the employee who couldn't be reached before the written offer was issued would be ineligible to receive severance, even if he/she rejected the offer for the identical reasons as the other employee.

Anthem made severance payments in accordance with its severance plan then in effect. Under the terms of the severance plan, if the employee was offered another position at Anthem (within certain pay grade ranges) or if an employee accepted employment with the successor contractor, then the employee was not entitled to severance. This position allows inherent consideration of factors that are critical to employment decision-making, such as the proximity of the place of employment to the employee's current residence, salary, benefits, opportunity for advancement etc. The position stated in the Report would appear to give no regard to these important factors. Anthem believes that its position was correct, and therefore disagrees with the recommendation stated in the Report.

Anthem appreciates your consideration of these comments. If you have any questions, please do not hesitate to call me at (203) 234-5140.

Sincerely,



Gayle T. Bassick  
Executive Counsel

cc: James Buccheri, Vice President & General Manager, Major Accounts  
Thomas R. Byrd, Vice President & General Manager, Finance

## ACKNOWLEDGMENTS

This report was prepared under the direction of Michael J. Armstrong, Regional Inspector General for Audit Services. Other principal Office of Audit Services staff who contributed include:

Robert Champagne, *Audit Manager*

Roger Lussier, *Senior Auditor*

Ilene Stanescki, *Auditor*

For information or copies of this report, please contact the Office of Inspector General's Public Affairs office at (202) 619-1343.