DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

MAY 19 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 The Regence Group for the Utah Segment (A-07-08-00278)

Attached is an advance copy of our final report on the termination claim for postretirement benefit (PRB) costs made by The Regence Group (Regence) for the Utah segment. We will issue this report to Medicare Northwest within 5 business days.

Regence administered the Utah 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 November 30, 2005. Throughout the period of its Medicare contracts, Regence accounted for the Utah postretirement benefit costs using the pay-as-you-go method. On August 6, 2008, Regence submitted a termination claim of $1,358,482 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 Regence's termination claim for PRB costs associated with the Utah Medicare Part A and B contracts was allowable for Medicare reimbursement.

Regence's entire termination claim of $1,358,482 in PRB costs for the Utah 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 Regence's Medicare contracts, none of the costs claimed were allowable.

We recommend that Regence withdraw its termination claim of $1,358,482 for PRB costs associated with the Utah Medicare Part A and B contracts.

In written comments on our draft report, Regence did not concur with our recommendation or with the termination claim amount. After reviewing Regence's comments and additional documentation, we revised our finding and recommendation to reflect a revised termination claim amount of $1,358,482. We maintain that Regence 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 e-mail at George.Reeb@oig.hhs.gov or Patrick J. Cogley, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591 or through e-mail at Patrick.Cogley@oig.hhs.gov. Please refer to report number A-07-08-00278.

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

MAY 22 2009

Report Number: A-07-08-00278

Mr. Mark Stimpson
Vice President
Medicare Northwest
2890 East Cottonwood Parkway
P.O. Box 30270
Salt Lake City, Utah 84130-0270

Dear Mr. Stimpson:

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 The Regence Group for the Utah Segment." 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 e-mail at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-08-00278 in all correspondence.

Sincerely,

Patrick J. Cogley

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 THE REGENCE GROUP FOR THE UTAH SEGMENT

Daniel R. Levinson
Inspector General

May 2009
A-07-08-00278

Office of Inspector General

http://oig.hhs.gov

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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

The Regence Group (Regence) administered the Utah 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 November 30, 2005. Throughout the period of its Medicare contracts, Regence accounted for the Utah 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 August 6, 2008, Regence submitted a termination claim of $1,358,482 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 Regence's termination claim for PRB costs associated with the Utah Medicare Part A and B contracts was allowable for Medicare reimbursement.

SUMMARY OF FINDING

Regence's entire termination claim of $1,358,482 in PRB costs for the Utah 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 Regence's Medicare contracts, none of the costs claimed were allowable.

RECOMMENDATION

We recommend that Regence withdraw its termination claim of $1,358,482 for PRB costs associated with the Utah Medicare Part A and B contracts.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, Regence did not concur with our recommendation or with the termination claim amount. Regence's written comments, excluding the attachments, are included as the Appendix.

After reviewing Regence's comments and additional documentation, we revised our finding and recommendation to reflect a revised PRB termination claim amount of $1,358,482. We maintain that Regence should withdraw the full claim amount.

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INTRODUCTION

BACKGROUND

The Regence Group (Regence) administered the Utah 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 November 30, 2005. Throughout the period of its Medicare contracts, Regence accounted for the postretirement benefit (PRB) costs associated with the Utah 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. 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 August 6, 2008, Regence submitted a termination claim of $1,358,482 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 Regence's termination claim for PRB costs associated with the Utah Medicare Part A and B contracts was allowable for Medicare reimbursement.

Scope

At the request of CMS, we audited the PRB termination claim of $1,358,482 that Regence submitted for the Utah Medicare Part A and B contracts' PRB costs. Achieving our objective did not require that we review Regence'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.

Methodology

We examined Regence's PRB claim in relation to applicable laws, regulations, and other Federal requirements. We also reviewed information presented in Regence's Termination Cost Voucher, which included support provided by Regence's consulting actuaries.

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

Regence's entire termination claim of $1,358,482 in PRB costs for the Utah 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 Regence'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

Regence's contractual relationship with CMS was terminated on November 30, 2005. On August 6, 2008, Regence submitted a termination claim of $1,358,482 to seek reimbursement for future PRB costs that Regence had not recognized prior to the termination of the Medicare contracts.

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

Regence 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. Regence did not obtain CMS approval before making this change, as required by the BPR. Therefore, Regence's claimed reimbursement for $1,358,482 in PRB costs was unallowable.

RECOMMENDATION

We recommend that Regence withdraw its termination claim of $1,358,482 for PRB costs associated with the Utah Medicare Part A and B contracts.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, Regence did not concur with our recommendation. A summary of Regence's comments and our response follows. Regence's comments, excluding four attachments (a previously issued Office of Inspector General report, a copy of Regence's audited financial statement, a revised termination claim, and an internal Regence computation sheet—which we excluded because of their volume), are contained in the Appendix. We have forwarded the four attachments in their entirety to CMS.

Change in Accounting Practice

Auditee Comments

Regence stated that our report ". . . is based on the erroneous factual predicate that this is a retroactive accounting change" and said that Regence had claimed costs using Statement of Financial Accounting Standards (SFAS) 106 accrual accounting since 1994.

Office of Inspector General Response

Although Regence has accounted for PRB costs using SFAS 106 for financial reporting purposes since 1994, it claimed PRB costs for Medicare reimbursement using the pay-as-you-go method throughout the entire period of its Medicare contracts. Therefore, calculating its termination claim using the accrual method represented a retroactive change in its accounting practice that was subject to approval by CMS. We confirmed with CMS that Regence did not seek approval for such a change.

Retroactive Change Permitted in Prior Audit

Auditee Comments

Regence stated that ". . . even if a contractor has not obtained advance CMS approval for an accounting change, the OIG still has permitted its retroactive application in some instances." Regence cited an earlier audit (A-07-07-00230) in which ". . . OIG permitted [Blue Cross Blue Shield of] South Carolina to retroactively apply accrual accounting, even where CMS had explicitly rejected the contractor's request to change to the accrual method."

Office of Inspector General Response

Regence did not accurately describe the facts relating to our audit of Blue Cross Blue Shield of South Carolina's PRB costs. For that contractor, CMS rejected the initial request to change to accrual accounting because of the funding mechanism that the contractor used. However, CMS approved the contractor's later request to change to accrual accounting after the contractor established the correct funding mechanism, subject to our audit.

Termination Claim Amount

Auditee Comments

Regence stated that the amount of its PRB termination claim was $1,358,482, not $1,441,707 as stated in our draft report. Regence explained that its actuarial consulting firm had recalculated the termination liability based on actual data after the contract termination date.

Office of Inspector General Response

We were unaware of the revised termination voucher until we received Regence's comments on our draft report. After obtaining additional documentation from Regence, we determined that Regence did submit a revised termination claim on August 6, 2008, in the amount of $1,358,482. We have revised our finding and recommendation to reflect this change. We maintain that Regence should withdraw the full claim amount.

APPENDIX

MAILING ADDRESS
Regence BlueCross BlueShield of Utah
P. O. Box 30270
Salt Lake City, Utah 84130-0270

Regence

Regence BlueCross BlueShield of Utah is an Independent Licensee of the Blue Cross and Blue Shield Association

2890 East Cottonwood Parkway
Salt Lake City, Utah 84121-7035
Tel (801) 333-2000
Customer Service (801) 333-2100
www.regence.com

January 16, 2009

VIA EMAIL and U.S. MAIL

Patrick J. Cogley
Regional Inspector General for Audit Services
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Re: Response to Draft Audit Report A-07-08-00278, "Review of Termination Claim for Postretirement Benefit Costs Made by The Regence Group for the Utah Segment"

Dear Mr. Cogley:

Thank you for the opportunity to respond to the above-referenced draft audit report regarding Regence Blue Cross Blue Shield of Utah's ("Regence") request for reimbursement of Medicare personnel post-retirement benefits ("PRB"). In that draft audit report, the Office of Inspector General made the following finding and recommendation:

> Regence's entire termination claim of $1,441,707 in PRB costs for the Utah 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 Regence's Medicare contracts, none of the costs claimed were allowable.

We do not concur with the recommendation for the following reasons.

First, the draft audit report is based on the erroneous factual predicate that this is a retroactive accounting change. In fact, as indicated in the attached Coopers & Lybrand "Report of Independent Accountants," Blue Cross and Blue Shield of Utah adopted Financial Accounting Standards Board Statement ("FAS") 106 accrual accounting for post retirement benefits in 1994. See Attachment A.

Over fourteen years have passed since the PRB change in January 1994, during which time there has been significant personnel turnover and company change. Thus, we have been unable to locate specific documentation identifying notice to CMS of the Company's adoption of FAS 106. The change in practice was well-documented in the public financial reports, however, which were available to CMS and state agencies.

We note, in this regard, that, Regence's Medicare contracts have been audited repeatedly since it adopted FAS 106. It is simply not credible for CMS to maintain that it had escaped CMS's attention that Regence had long since adopted the accrual basis accounting, of which FAS 106 is an integral part. Additionally, in audit report A-07-08-00282, "Review of Postretirement Benefit Costs Claimed For Medicare Reimbursement By The Regence Group – Oregon for Fiscal Years 1992 Through 2005," (Nov. 2008), your Office acknowledged that Regence used accrual accounting for Oregon's PRB costs. Thus, it seems reasonable that Regence also would use the same accounting for Utah's PRB costs.

Second, the draft report appears to confuse reimbursement limitations in FAR 31.205-6(o) with accounting methods. FAR 31.205-6(o) itself deviates from generally accepted accounting principles by declining to recognize accrued costs – in this instance, accrued postretirement benefit liabilities that are not funded. By limiting the reimbursement of postretirement benefits to amounts actually funded, FAR 31.205-6(o) deems contractors to be on a pay-as-you-go basis for reimbursement purposes. But this is solely a limitation on reimbursement and not a mandated accounting method.

In amending its pre-existing VEBA to hold funds for accrued postretirement liabilities, Regence merely implemented a vehicle for funding such benefits. It did not change its accounting methods in any way; it simply funded the present value of a previously recorded, accrued cost. Thus, while Regence has "estimated, accumulated, and reported" costs on a consistent basis since 1994, CMS has benefited from a cost principle that limits reimbursements to amounts actually funded. As long as a U.S. Government contractor remains a U.S. Government contractor, this limitation on reimbursement only gives rise to a timing differential, i.e., one that postpones reimbursement until cash outlays match accrued liabilities. Regence's termination of its Medicare contracts is a change in circumstance that obviously affects the equation implicit in FAR 31.205-(6)(o), which is that postretirement benefits will ultimately be reimbursed over time. The termination cost principle, FAR 31.205-42, recognizes that terminations are exceptional circumstances that alters reimbursement calculations. Accordingly, what Regence has done in this Termination setting is wholly consistent with the operation of FAR 31.205-6(o), which is to seek reimbursement of postretirement benefits actually funded and accrued.

Third, even if a contractor has not obtained advance CMS approval for an accounting change, the OIG still has permitted its retroactive application in some instances. Here, the 2008 draft audit recommendation is based upon the erroneous conclusion that "Medicare contracts do not permit retroactive changes in accounting practices without advance CMS approval . . . ." *See* Draft Report at 2. Yet in a different post-retirement benefits (PRB) audit earlier that same year, the OIG permitted South Carolina to retroactively apply accrual accounting, even where CMS had explicitly rejected the contractor's request to change to the accrual method. *See, e.g.*, "Review of Postretirement Benefit Costs Claimed for Blue Cross Blue Shield of South Carolina for Fiscal Years 2000-04" (A-07-07-00230), February 2008 at 1 (Attachment B). The OIG applied accrual accounting pursuant to FAS 106 to increase South Carolina's claimed PRB costs in fiscal years both preceding and following CMS's denial. The OIG did so even though South Carolina's normal accounting practice had been "*contrary to the requirements of SFAS 106*" and the FAR. *Id.* (emphasis added). Here the draft audit report recommendation rests entirely upon inconsistently applied language in a CMS Budget and Performance Requirement letter, which the OIG and CMS specifically declined to enforce as a requirement just months earlier.

Alternatively, in the event that your Office determines that only pay-as-you-go accounting must be applied for the years at issue, then CMS should reimburse Regence for its direct costs during FYs 1995-99. Since 1994, Regence (Utah) has utilized the accrual basis for recognizing PRB costs as described in FAR 31.205-6(o)(2)(iii). Pursuant to the FAR, these costs have been measured and assigned in accordance with generally accepted accounting principles, such as FAS 106, and calculated in accordance with generally accepted actuarial principles and practices. In addition to the VEBA contributions, Regence also liquidated its accrued PRB costs through direct benefit payments. As a result, both contribution methods can be used to satisfy the funding requirements of FAR 31.205-6(o)(3) when they have the effect of reducing the accumulated PRB obligation. Therefore, in the alternative, Regence requests full reimbursement for the accrued funded PRB costs from open past years as outlined in the Appendix at Attachment C. This portion of the total requested amount is $454,630.

Lastly, we should note that Regence's certified claim for Utah PRB costs is actually in the amount of $1,358,482, not $1,441,707. The draft audit relies on an earlier estimate provided by Regence's actuaries (Towers Perrin) in a letter dated November 14, 2005. Based on this information, Regence funded the $1,555,538 termination liability prior to the end of the CMS contract. Of that amount, $1,441,707 was attributed to the Utah CMS contract and $113,831 to the Oregon contract. After the termination date Towers Perrin recalculated the termination liability and updated their estimate in 2006 based on actual termination data. The total liability increased to $1,810,558 with $1,358,482 attributable to the Utah Plan and $452,106 attributable to the Oregon Plan. Regence provided the updated Towers Perrin report to CMS in April 2006 as part of the termination voucher. Regence then fully funded the difference between the estimates, and filed a certified claim dated August 6, 2008 with CMS, which included the $1,810,558 for PRB termination costs. See Attachment D. Thus, Regence respectfully requests that the draft audit report be amended to reflect Regence's actual costs and the amount requested in the certified claim.

Please do not hesitate to contact me at (801) 333-2000 to discuss this response.

Sincerely,

Mark Stimpson
Vice President of Medicare