DEPARTMENT OF HEALTH & HUMAN SERVICES Office of Inspector General

Washington, D.C. 20201

DEC 27 2007

TO: Kerry Weems
Acting Administrator
Centers for Medicare & Medicaid Services

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

SUBJECT: Review of Postretirement Benefit Costs Claimed for TrailBlazer Health Enterprises for Medicare Reimbursement by Blue Cross Blue Shield of South Carolina for Fiscal Years 2000 Through 2004 (A-07-07-00229)

Attached is an advance copy of our final report on postretirement benefit (PRB) costs claimed for Medicare reimbursement by Blue Cross Blue Shield of South Carolina (South Carolina) for its TrailBlazer Health Enterprises (TrailBlazer) subsidiary. We will issue this report to South Carolina within 5 business days.

Our objective was to determine the allowability of TrailBlazer's PRB costs that South Carolina claimed for Medicare reimbursement for fiscal years (FY) 2000 through 2004.

South Carolina overclaimed TrailBlazer's accrued PRB costs on the final administrative cost proposals (FACP) for FYs 2000 through 2004. We determined that the allowable accrued PRB costs for this period were $2,355,247. However, South Carolina claimed accrued PRB costs of $4,045,529 on the FACPs because it did not compute PRB costs in accordance with its Medicare contract and an agreement with the Centers for Medicare & Medicaid Services. As a result, South Carolina overclaimed $1,690,282 in accrued PRB costs for FYs 2000 through 2004.

We recommend that South Carolina revise TrailBlazer's FACPs for FYs 2000 through 2004 to reduce its claimed PRB costs by $1,690,282. We also recommend that South Carolina claim future PRB costs in accordance with the Medicare contract.

In written comments on our draft report, South Carolina did not concur with our recommendations. South Carolina stated that it could not agree with our determination of the allowable costs until it was assured that the Federal Government had reimbursed the funds deposited by South Carolina that were received from Health Care Services Enterprises (HCSC). Additionally, South Carolina stated that it was its understanding that contributions in excess of the reimbursable limits created a prepayment credit that could be applied to future funding requirements.

After reviewing South Carolina's comments, we continue to support our recommendations. South Carolina was incorrect in stating that the PRB asset transfer was a South Carolina contribution; the trust assets transferred from HCSC were not a plan contribution. Because the transfer was not a contribution, there was no prepayment credit.

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. Please refer to report number A-07-07-00229.

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

DEC 28 2007

Report Number: A-07-07-00229

Mr. Joseph D. Wright, CPA
Vice President and Chief Financial Officer
Blue Cross Blue Shield of South Carolina
P.O. Box 100134
Columbia, South Carolina 29202-3134

Dear Mr. Wright:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of Postretirement Benefit Costs Claimed for TrailBlazer Health Enterprises for Medicare Reimbursement by Blue Cross Blue Shield of South Carolina for Fiscal Years 2000 Through 2004." 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 principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5). Accordingly, within 10 business days after the final report is issued, it 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-07-07-00229 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Mr. Tom Lenz, Consortium Administrator
Consortium for Financial Management and Fee-for-Service Operations
Centers for Medicare & Medicaid Services
601 East 12th Street, Room 235
Kansas City, Missouri 64106

Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

REVIEW OF POSTRETIREMENT BENEFIT COSTS CLAIMED FOR TRAILBLAZER HEALTH ENTERPRISES FOR MEDICARE REIMBURSEMENT BY BLUE CROSS BLUE SHIELD OF SOUTH CAROLINA FOR FISCAL YEARS 2000 THROUGH 2004

DEPARTMENT OF HEALTH & HUMAN SERVICES · USA

Daniel R. Levinson
Inspector General

December 2007
A-07-07-00229

Office of Inspector General

http://oig.hhs.gov

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In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent 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.

DEPARTMENT OF HEALTH & HUMAN SERVICES·USA

EXECUTIVE SUMMARY

BACKGROUND

Blue Cross Blue Shield of South Carolina (South Carolina) administers Medicare Part A and Part B operations in its TrailBlazer Health Enterprises (TrailBlazer) and Palmetto Government Benefit Administrators subsidiaries under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS). South Carolina acquired TrailBlazer from Blue Cross Blue Shield of Texas (Texas) in October 1999 after Texas merged with Health Care Services Enterprises (HCSC). As part of the sales agreement between HCSC and South Carolina, HCSC funded TrailBlazer PRB liabilities in a grantor trust and transferred the PRB trust and liabilities to South Carolina.

In claiming postretirement benefit (PRB) costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and applicable Cost Accounting Standards, as required by the Medicare contract.

In fiscal year (FY) 2000, South Carolina submitted a request to CMS to use accrual accounting for PRBs, and the parties began negotiations to resolve any compliance issues. South Carolina received a revocable grantor trust along with associated liabilities for the TrailBlazer PRB plan from HCSC and began claiming accrued costs in FY 2000. As part of the resolution of compliance issues, South Carolina agreed to use a Voluntary Employee Benefit Association (VEBA) trust to replace the revocable grantor trust and thereby met the FAR 31.205-6(o) and Statement of Financial Accounting Standards 106 requirements for recognition of the trust as a plan asset. In FY 2005, South Carolina finalized the VEBA and moved the funds from the revocable grantor trust. As part of this process, CMS and South Carolina entered into an agreement in December 2004 that stated that once the VEBA was established, all future years' accrued PRB costs would be computed using trust assets as plan assets.

Following the close of each FY, South Carolina submits a final administrative cost proposal (FACP) to CMS reporting the administrative costs of performing Medicare functions during the year. The accrued PRB cost is part of the administrative cost of performing Medicare functions and, as such, is claimed on each FY's FACP.

OBJECTIVE

Our objective was to determine the allowability of TrailBlazer's PRB costs that South Carolina claimed for Medicare reimbursement for FYs 2000 through 2004.

SUMMARY OF FINDING

South Carolina overclaimed TrailBlazer's accrued PRB costs on the FACPs for FYs 2000 through 2004. We determined that the allowable accrued PRB costs for this period were $2,355,247. However, South Carolina claimed accrued PRB costs of $4,045,529 on the FACPs because it did not compute PRB costs in accordance with its Medicare contract (which relies on the FAR for determination of allowable PRB costs) and the agreement with CMS. Specifically, South Carolina did not fully recognize trust plan assets or their related impact (i.e., recognition of investment return on plan assets) in its determination of PRB costs. As a result, South Carolina overclaimed $1,690,282 in accrued PRB costs for FYs 2000 through 2004.

RECOMMENDATIONS

We recommend that South Carolina revise TrailBlazer's FACPs for FYs 2000 through 2004 to reduce its claimed PRB costs by $1,690,282. We also recommend that South Carolina claim future PRB costs in accordance with the Medicare contract.

AUDITEE'S COMMENTS

In written comments on our draft report, South Carolina did not concur with our recommendations. South Carolina stated that it could not agree with our determination of the allowable costs until it was assured that the Federal Government had reimbursed the funds deposited by South Carolina that were received from HCSC. Additionally, South Carolina stated that it was its understanding that contributions in excess of the reimbursable limits created a prepayment credit that could be applied to future funding requirements.

South Carolina's comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

After reviewing South Carolina's comments, we continue to support our recommendations. South Carolina was incorrect in stating that the PRB asset transfer was a South Carolina contribution. As part of the sales agreement between HCSC and South Carolina, HCSC transferred PRB assets to South Carolina. For that reason, South Carolina will not have to make contributions to cover the PRB liability earned by employees prior to the acquisition of TrailBlazer. Therefore, the trust assets (the PRB liability funded by HCSC) that HCSC transferred to South Carolina did not constitute a contribution by South Carolina.

Although South Carolina was correct in stating that contributions in excess of reimbursable limits create a prepayment credit, the trust assets transferred from HCSC were not a plan contribution. Because the transfer was not a contribution, there was no prepayment credit.

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Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
FACP	final administrative cost proposal
FAR	Federal Acquisition Regulation
FY	fiscal year
PRB	postretirement benefit
SFAS	Statement of Financial Accounting Standards
VEBA	voluntary employees benefit association

INTRODUCTION

BACKGROUND

South Carolina and Medicare

Blue Cross Blue Shield of South Carolina (South Carolina) administers Medicare Part A and Part B operations in its TrailBlazer Health Enterprises (TrailBlazer) and Palmetto Government Benefit Administrators subsidiaries under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS). South Carolina acquired TrailBlazer from Blue Cross Blue Shield of Texas (Texas) in October 1999 after Texas merged with Health Care Services Enterprises (HCSC). As part of the sales agreement between HCSC and South Carolina, HCSC funded TrailBlazer PRB liabilities in a grantor trust and transferred the PRB trust and liabilities to South Carolina.

In claiming postretirement benefit (PRB) costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and applicable Cost Accounting Standards, as required by the Medicare contract.

Federal Requirements

Medicare reimburses a portion of the funded accruals that contractors charge for their PRB plans. FAR 31.205-6(o) requires that, to be allowable for Medicare reimbursement, PRB accrual costs be determined in accordance with Statement of Financial Accounting Standards (SFAS) 106 and funded in a dedicated trust fund, such as a voluntary employees benefit association (VEBA) trust.

SFAS 106 addresses how both the value of trust fund assets and investment return are an integral component in the computation of accrued PRB costs. Specifically, SFAS 106 identifies service cost, interest cost, return on plan assets, amortization of unrecognized prior service cost, gains or losses, and amortization of the unrecognized transition obligation or asset as the components of PRB costs. Furthermore, SFAS 106 mandates that for a funded plan, the actual return on plan assets shall be determined based on the fair value of plan assets at the beginning of the period, adjusted for contributions and benefit payments.

Since 1993, the Budget and Performance Requirements instructions sent to Medicare contractors have included a reminder of the special provisions regarding PRB plan costs. The instructions specify that any proposed change in accounting practice for PRB costs must be submitted to CMS in advance for approval.

South Carolina's Request To Use Accrual Accounting

In fiscal year (FY) 2000, South Carolina submitted a request to CMS to use accrual accounting for PRBs. South Carolina established a revocable grantor trust for the TrailBlazer PRB plan and began claiming accrued costs in FY 2000. In 2001, CMS denied South Carolina's request because it used a revocable grantor trust, rather than a VEBA trust, as the funding vehicle, contrary to the requirements of SFAS 106. In 2002, South Carolina notified CMS of its intent to convert the revocable grantor trust to a VEBA trust, to compute accrual costs in accordance with SFAS 106, and to comply with CMS's other conditions. In FY 2005, South Carolina established the VEBA trust and moved the funds from the revocable grantor trust to meet the FAR 31.205-6(o) and SFAS 106 requirements for recognition of the trust as a plan asset. As part of this process, CMS and South Carolina entered into an agreement in December 2004 that stated that once the VEBA was established, all future years' accrued PRB costs would be computed using trust assets as plan assets.

Following the close of each FY, South Carolina submits a final administrative cost proposal (FACP) to CMS reporting the administrative costs of performing Medicare functions during the year. The accrued PRB cost is part of the administrative cost of performing Medicare functions and, as such, is claimed on each FY's FACP.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine the allowability of TrailBlazer's PRB costs that South Carolina claimed for Medicare reimbursement for FYs 2000 through 2004.

Scope

We reviewed $4,045,529 of TrailBlazer's accrued PRB costs that South Carolina claimed for Medicare reimbursement on its FACPs for FYs 2000 through 2004. The objective did not require that we review South Carolina's overall internal control structure. However, we did review the controls related to the accrued PRB costs claimed for Medicare reimbursement to ensure that the PRB costs were allowable pursuant to the FAR.

We performed fieldwork at South Carolina's corporate office in Columbia, South Carolina, in January 2007.

Methodology

We reviewed applicable Federal requirements. We also identified TrailBlazer's accrued PRB costs as claimed by South Carolina on its FACPs. Pursuant to CMS's agreement with South Carolina, we determined the extent to which South Carolina funded the PRB costs with contributions to both the grantor trust fund, whose assets were later transferred to the VEBA trust funds, and the VEBA trust fund itself. In performing our review, we used information provided by South Carolina's actuarial consulting firm. The CMS Office of the Actuary staff used this information to develop PRB costs for TrailBlazer based on SFAS 106 methodology. In turn, we verified the actuarial data and used it to calculate the PRB costs that were allowable for Medicare reimbursement on the FACPs for FYs 2000 through 2004.

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

FINDING AND RECOMMENDATIONS

OVERCLAIMED BENEFIT COSTS

South Carolina overclaimed TrailBlazer's accrued PRB costs on the FACPs for FYs 2000 through 2004. We determined that the allowable accrued PRB costs for this period were $2,355,247. However, South Carolina claimed accrued PRB costs of $4,045,529 on the FACPs because it did not compute PRB costs in accordance with its Medicare contract (which relies on the FAR for determination of allowable PRB costs) and the agreement with CMS. Specifically, South Carolina did not fully recognize trust plan assets or their related impact (i.e., recognition of investment return on plan assets) in its determination of PRB costs. As a result, South Carolina overclaimed $1,690,282 in PRB costs for FYs 2000 through 2004.

South Carolina determined PRB costs for TrailBlazer in accordance with SFAS 106. However, because the VEBA trust was not established until 2005, South Carolina's consulting actuarial firm did not recognize any plan assets in the determination of annual PRB costs. Because South Carolina did not recognize plan assets, there were no reductions to PRB costs relating to investment returns. Not reducing costs for investment returns for each year of our audit period resulted in overstating PRB costs on the FACPs. As a result, South Carolina claimed more accrued PRB costs than it actually incurred.

Because South Carolina transferred funds from the revocable grantor trust to the VEBA trust, we followed CMS's agreement with South Carolina and fully considered trust assets and the investment returns in our calculation of each year's allowable PRB costs. We then compared allowable accrued PRB costs with those claimed on TrailBlazer's FACPs, as shown in the table below.

Results of Audit

FY	Claimed by South Carolina	Per Audit	
		Allowable	Unallowable
2000	$664,563	$368,912	$295,651
2001	638,812	352,761	286,051
2002	812,586	472,901	339,685
2003	918,317	571,238	347,079
2004	1,011,251	589,435	421,816
Total	**$4,045,529**	**$2,355,247**	**$1,690,282**

Appendix A presents details on the allowable accrued costs.

RECOMMENDATIONS

We recommend that South Carolina revise TrailBlazer's FACPs for FYs 2000 through 2004 to reduce its claimed PRB costs by $1,690,282. We also recommend that South Carolina claim future PRB costs in accordance with the Medicare contract.

AUDITEE'S COMMENTS

In written comments on our draft report, South Carolina did not concur with our recommendations. South Carolina stated that it could not agree with our determination of the allowable costs until it was assured that the Federal Government had reimbursed all contributions to the trust, specifically, the funds deposited by South Carolina that were received from HCSC. Additionally, South Carolina stated that it was its understanding that contributions in excess of the reimbursable limits created a prepayment credit that could be applied to future funding requirements.

South Carolina's comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

After reviewing South Carolina's comments, we continue to support our recommendations. South Carolina was incorrect in stating that the PRB asset transfer was a South Carolina contribution. As part of the sales agreement between HCSC and South Carolina, HCSC transferred PRB assets to South Carolina. For that reason, South Carolina will not have to make contributions to cover the PRB liability earned by employees prior to the acquisition of TrailBlazer. Therefore, the trust assets (the PRB liability funded by HCSC) that HCSC transferred to South Carolina did not constitute a contribution by South Carolina.

Although South Carolina was correct in stating that contributions in excess of reimbursable limits create a prepayment credit, the trust assets transferred from HCSC were not a plan contribution. Because the transfer was not a contribution, there was no prepayment credit.

APPENDIXES

	Description		**TrailBlazer**
1999 1/	Contribution deposits	2/	$175,955
1.38%	Discount for interest	3/	(8,881)
	Pres val contributions	4/	167,074
	Prepayment credit	5/	0
	Pres value of funding		167,074
		6/	
	Assigned PRB cost	7/	103,584
	Absorbed credit	8/	0
	CAS funding target	9/	103,584
	% Funded	10/	100.00%
	Funded PRB cost	11/	103,584
	Allowable interest	12/	1,899
	Allocable PRB cost	13/	$105,483
	Fiscal year PRB cost		NA
	Medicare LOB* percentage		NA
	Allowable PRB cost		NA

2000	Contribution deposits		$629,659
5.50%	Discount for interest		(23,201)
	Pres val contributions		606,458
	Prepayment credit		64,363
	Pres value of funding		670,821
	Assigned PRB cost		340,669
	Absorbed credit		0
	CAS funding target		340,669
	% Funded		100.00%
	Funded PRB cost		340,669
	Allowable interest		10,570
	Allocable PRB cost		351,239
	Fiscal year PRB cost	14/	368,912
	Medicare LOB* percentage	15/	100.00%
	Allowable PRB cost	16/	$368,912

	Description	**TrailBlazer**
2001	Contribution deposits	$603,339
5.50%	Discount for interest	(52,670)
	Pres val contributions	550,669
	Prepayment credit	348,310
	Pres value of funding	898,979
	Assigned PRB cost	353,082
	Absorbed credit	0
	CAS funding target	353,082
	% Funded	100.00%
	Funded PRB cost	353,082
	Allowable interest	186
	Allocable PRB cost	353,268
	Fiscal year PRB cost	352,761
	Medicare LOB* percentage	100.00%
	Allowable PRB cost	$352,761

2002	Contribution deposits	$848,852
5.50%	Discount for interest	(74,328)
	Pres val contributions	774,524
	Prepayment credit	512,778
	Pres value of funding	1,287,302
	Assigned PRB cost	512,778
	Absorbed credit	0
	CAS funding target	512,778
	% Funded	100.00%
	Funded PRB cost	512,778
	Allowable interest	0
	Allocable PRB cost	512,778
	Fiscal year PRB cost	472,901
	Medicare LOB* percentage	100.00%
	Allowable PRB cost	$472,901

	Description	TrailBlazer
2003	Contribution deposits	$881,433
5.50%	Discount for interest	(77,215)
	Pres val contributions	804,218
	Prepayment credit	590,724
	Pres value of funding	1,394,942
	Assigned PRB cost	590,724
	Absorbed credit	0
	CAS funding target	590,724
	% Funded	100.00%
	Funded PRB cost	590,724
	Allowable interest	0
	Allocable PRB cost	590,724
	Fiscal year PRB cost	571,238
	Medicare LOB* percentage	100.00%
	Allowable PRB cost	$571,238

2004	Contribution deposits	$1,028,288
5.50%	Discount for interest	(89,632)
	Pres val contributions	938,656
	Prepayment credit	589,005
	Pres value of funding	1,527,661
	Assigned PRB cost	589,005
	Absorbed credit	0
	CAS funding target	589,005
	% Funded	100.00%
	Funded PRB cost	589,005
	Allowable interest	0
	Allocable PRB cost	589,005
	Fiscal year PRB cost	589,435
	Medicare LOB* percentage	100.00%
	Allowable PRB cost	$589,435

* Line of business

FOOTNOTES

1/ South Carolina acquired TrailBlazer from Blue Cross Blue Shield of Texas in October 1999. Therefore, the calculation of allocable costs for 1999 represents the last quarter of the calendar year and is included in fiscal year 2000 allocable costs. The 1.38% discount for interest represents one-fourth of the annual rate.

2/ Total contributions to the trust fund are the deposits made to the Voluntary Employee Benefit Association (VEBA) trust fund. Such contributions can be used to satisfy the funding requirements of Federal Acquisition Regulation (FAR) 31.205-6(o)(2)(iii) and Cost Accounting Standards (CAS) 416-50(a)(1)(v)(A). The contributions included deposits made during the plan year and the discounted value of accrued contributions deposited after the end of the plan year but within the time allowed for filing tax returns.

3/ Interest is determined using the Statement of Financial Accounting Standards (SFAS) 106 expected long-term rate of return.

4/ The present value of contributions is the value of the contributions discounted from the date of deposit back to the first day of the plan year.

5/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year current period funding requirement. A prepayment credit may be carried forward, with interest, to the first of each subsequent plan year until needed to fund future PRB costs. The accumulated value of prepayment credits is available as of the first day of the plan year and is applied as of the first day of the plan year to cover the cost assigned to the period.

6/ The present value of funding represents the present value of contributions plus accumulated prepayment credits. This is the amount of funding that is available to cover the current period funding requirement measured at the first day of each plan year.

7/ The assigned PRB costs, computed on January 1 of each year, provide the basis to compute the allowable PRB cost that can be charged to Medicare.

8/ Cost credits are created when the PRB cost is a negative value. They are accumulated at the long-term rate, and any accumulated unabsorbed credits are applied to subsequent positive CAS PRB costs before any prepayment credits or contributions are applied. Also, because the unabsorbed credits are created by assets that have already been recognized for reimbursement, the credit is not eligible to be claimed when "absorbed."

9/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of FAR 31.205-6(j)(3)(I).

FOOTNOTES (Cont.)

10/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Because any funding in excess of the CAS funding target is considered premature funding in accordance with CAS 412.50(a)(7), the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS funding target. For purposes of illustration, the percentage of funding has been rounded to four decimals.

11/ We computed the funded CAS PRB cost as the CAS funding target multiplied by the percent funded.

12/ We assumed that interest on the funded PRB cost, less the applied prepayment credit, accrues in the same proportion that the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(o)(4), which provides that interest costs are unallowable if caused by a delay in funding beyond 30 days after the end of the quarter to which they are assigned.

13/ The allocable PRB cost is the amount of PRB cost that may be allocated for contract costing purposes.

14/ We converted the plan year allocable PRB costs to a Federal fiscal year (FY) basis (October 1 through September 30). We calculated the FY PRB costs as 1/4 of the prior year's costs plus 3/4 of the current year's costs.

15/ We determined that TrailBlazer is 100% dedicated to Medicare operations, and therefore, all of the allocable costs were allowable for Medicare reimbursement.

16/ We computed the allowable Medicare PRB cost as the FY PRB cost multiplied by the Medicare line of business percentage.

Palmetto GBA
Post Office Box 100134
Columbia, South Carolina 29202-3134

Joe Wright
Vice President and CFO

August 22, 2007

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

RE: Audit Report Number A-07-07-00229

Dear Mr. Cogley:

We are responding to your draft audit report dated June 14, 2007 entitled "Review of Postretirement Benefit Costs Claimed for TrailBlazer Health Enterprises for Medicare Reimbursement by Blue Cross Blue Shield of South Carolina for Fiscal Years 2000 Through 2004."

The audit contained the following recommendation with which we do not concur.

Recommendation:
We recommend that South Carolina revise TrailBlazer's FACPs for FYs 2000 through 2004 to reduce its claimed costs by $1,690,282. We also recommend that South Carolina claim future PRB costs in accordance with the Medicare contract.

Comment:
We agree that the FAS 106 expense calculations that were the basis for past reimbursement calculations did not reflect the assets that were in the grantor trust.

However, we are unable to agree with the recommendations of this audit to the extent funds received by us from HCSC and the related earnings were used to adjust the reimbursable costs.

Until we can satisfactorily determine that the government has provided reimbursement for the contributions to the trust (specifically for the funds deposited by us that were received from HCSC and to the best of our knowledge, claimed by HCSC as reimbursable termination expenses related to its Medicare contracts), we are unable to agree with the determination of allowable costs.

It is our understanding that the contributions in excess of the reimbursable limits create a prepayment credit that can be applied to meet future funding requirements. Therefore, no cost is forfeited, but merely deferred to future periods

If you have any questions, please feel free to contact me at 803-763-5544.

Sincerely,

Joe Wright

Cc: Eric Shipley, OACT-CMS
William R. Horton, BCBSSC
Bruce Hughes, Palmetto GBA
Marti Mahaffey, Trailblazer
Bob Leichtle, BCBSSC