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

MAR 29 2007

Report Number: A-07-06-00206

Mr. Dan Bloodworth
Senior Vice President and Chief Financial Officer
Pinnacle Business Solutions, Inc.
515 Pershing Boulevard
North Little Rock, Arkansas 72114

Dear Mr. Bloodworth:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Medicare Contractor's Pension Segmentation Requirements at Arkansas Blue Cross Blue Shield and Pension Plan Termination." A copy of this report will be forwarded to the HHS action official noted on the next page for his review and any action deemed necessary.

The HHS action official will make final determination regarding actions taken on all matters in the report. 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 are made available to the public to the extent the information is not subject to exemptions of 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, or Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through email at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-06-00206 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Dr. Randy Farris
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Centers for Medicare & Medicaid Services
1301 Young Street, Suite 714
Dallas, Texas 75202

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF MEDICARE CONTRACTOR'S PENSION SEGMENTATION REQUIREMENTS AT ARKANSAS BLUE CROSS BLUE SHIELD AND PENSION PLAN TERMINATION

Daniel R. Levinson
Inspector General

March 2007
A-07-06-00206

Office of Inspector General

http://oig.hhs.gov

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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

Arkansas Blue Cross Blue Shield (Arkansas) administers both Medicare Part A and Part B operations under the cost reimbursement contracts with Centers for Medicare & Medicaid Services (CMS). On March 16, 1998, Arkansas's Board of Directors voted to terminate its qualified defined benefit pension plan effective June 30, 1998; however, distributions of the participants' accrued benefits were not made until May 1, 1999. After these distributions were made, excess assets remained in the pension plan fund and reverted to Arkansas.

Starting with fiscal year 1988, CMS incorporated segmentation requirements into Medicare contracts. The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the segment. Additionally, the contract requires Medicare segment assets to be updated for each year after the initial allocation in accordance with Cost Accounting Standards (CAS) 412 and 413. Furthermore, in situations such as pension plan terminations, the Medicare contract requires contractors to identify excess Medicare pension assets/liabilities in accordance with CAS 413.

OBJECTIVES

Our objective was to determine whether Arkansas complied with the Medicare contract's pension segmentation requirements while:

- implementing the prior audit finding,
- updating Medicare segment assets from January 1, 1996, to May 1, 1999, and
- determining the excess assets that should be remitted to Medicare as a result of the termination of its defined benefit pension plan.

SUMMARY OF FINDINGS

Arkansas properly implemented the prior audit recommendation; however, it did not comply with the Medicare contract's pension segmentation requirements while updating the Medicare segment's assets from January 1, 1996, to May 1, 1999. As a result, Arkansas overstated the Medicare segment assets by $546,859.

In addition, Arkansas did not comply with the CAS in determining Medicare's share of the excess pension assets as of May 1, 1999. Arkansas calculated and remitted to the Federal government $1,125,543 as Medicare's share of the excess pension assets, which is a $16,711 overstatement. The overstatement occurred because Arkansas incorrectly included the unrecognized accumulated cost deficit as an adjustment to the calculation of excess assets. Medicare's share of the total excess pension assets as of May 1, 1999 was $1,108,832.

RECOMMENDATION

We recommend that Arkansas decrease Medicare's share of the excess pension assets by $16,711, and adjust its Final Administrative Cost Proposal to properly reflect Medicare's share of the excess assets.

AUDITEE'S COMMENTS

In written comments on our draft report, Arkansas disagreed that it failed to include the excise tax as an adjustment to the calculation of the excess pension assets. Arkansas also disagreed that it failed to remit Medicare's share of the excess assets to the Federal government. Arkansas's comments are included in their entirety as Appendix D.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

After reviewing Arkansas's comments and the additional documentation provided by Arkansas, we determined that it had included the excise tax as an adjustment to the calculation of the excess assets. In addition, we determined that Arkansas did remit $1,125,543 as Medicare's share of the excess assets to the Federal government. Therefore, we modified the audit findings and recommendation to reflect Arkansas's comments.

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Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
FAR	Federal Acquisition Regulations
OIG	Office of Inspector General
Arkansas	Arkansas Blue Cross Blue Shield

INTRODUCTION

BACKGROUND

Arkansas

Arkansas Blue Cross Blue Shield (Arkansas) administers both Medicare Part A and Part B operations under the cost reimbursement contracts with Centers for Medicare & Medicaid Services (CMS). On March 16, 1998, Arkansas's Board of Directors voted to terminate its qualified defined benefit pension plan effective June 30, 1998; however, distributions of the participants' accrued benefits were not made until May 1, 1999. After these distributions were made, excess assets remained in the pension plan fund and reverted to Arkansas.

Segmentation Requirements

CMS incorporated segmentation requirements into Medicare contracts starting in fiscal year 1988. The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the segment. Furthermore, the contract requires Medicare segment assets to be updated for each year after the initial allocation in accordance with Cost Accounting Standards (CAS) 412 and 413. Finally, in claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), CAS, and Medicare contract.

Regulations

The CAS 412 regulates the determination and measurement of pension cost components. It also regulates the assignment of pension costs to appropriate accounting periods.

The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

The CAS 413 also regulates the determination of segment assets and liabilities in the event of contract terminations, segment closings, and pension plan terminations.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objective was to determine whether Arkansas complied with the Medicare contract's pension segmentation requirements while:

- implementing the prior audit finding,
- updating Medicare segment assets from January 1, 1996, to May 1, 1999, and

- determining the excess assets that should be remitted to Medicare as a result of the termination of its defined benefit pension plan.

Scope

We reviewed Arkansas's identification of its Medicare segment and update of Medicare segment assets from January 1, 1996, to May 1, 1999. Arkansas's defined benefit pension plan was terminated on June 30, 1998; however, it was not until May 1, 1999 that Arkansas liquidated the accrued benefits of the plan participants.

Achieving our objectives did not require us to review Arkansas's overall internal control structure. However, we did review controls relating to the identification of the Medicare segment, the update of the segment's assets, and the determination of the final segment liabilities to ensure adherence to the Medicare contract, CAS 412, and CAS 413.

We performed fieldwork at Arkansas's office in Little Rock, Arkansas, during February 2006.

Methodology

In performing this review, we used information provided by Arkansas's actuarial consulting firm. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed Arkansas's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s. The CMS Office of the Actuary staff used the documents to calculate Medicare segment assets as of May 1, 1999. We reviewed the methodology and calculations.

We performed this review in conjunction with our audit of the pension costs claimed for Medicare reimbursement (A-07-06-00208). The information obtained and reviewed during the audit also was used in performing this review.

Details of the Medicare segment's updated pension assets from January 1, 1996, to May 1, 1999, are presented in Appendix A. In addition, details of the calculation of excess assets as of May 1, 1999 are presented in Appendix B.

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

FINDINGS AND RECOMMENDATION

Arkansas properly implemented the prior audit recommendation; however, it did not comply with the Medicare contract's pension segmentation requirements while updating the Medicare segment's assets from January 1, 1996, to May 1, 1999. As a result, Arkansas overstated the Medicare segment assets by $546,859. In addition, Arkansas did not comply with the CAS when determining Medicare's share of the excess assets as of May 1, 1999.

In addition, Arkansas did not comply with the CAS in determining Medicare's share of the excess pension assets as of May 1, 1999. Arkansas calculated and remitted to the Federal government $1,125,543 as Medicare's share of the excess pension assets, which is a $16,711 overstatement. The overstatement occurred because Arkansas incorrectly included the unrecognized accumulated cost deficit as an adjustment to the calculation of excess assets. Medicare's share of the total excess pension assets as of May 1, 1999 was $1,108,832.

UPDATE OF MEDICARE SEGMENT ASSETS

Cost Accounting Standards

The Medicare contract states that: ". . . the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7)." The CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses. In addition, CAS 413.50(c)(8) requires an adjustment to be made for transfers (participants who enter or leave the segment) if the transfers materially affect the segment's ratio of pension plan assets to actuarial accrued liabilities.

Furthermore, the CAS 412.50(c)(1) states: "Amounts funded in excess of the pension cost computed for a cost accounting period pursuant to the provisions of this Standard shall be accounted for as a prepayment credit and carried forward to future accounting periods."

Medicare Segment Assets as of January 1, 1996, Updated to May 1, 1999

Arkansas properly implemented the prior audit recommendation; however, it did not comply with the Medicare contract's pension segmentation requirements while updating its Medicare segment assets from January 1, 1996, to May 1, 1999. We identified Medicare segment assets of $948,692 as of May 1, 1999; however, Arkansas identified Medicare segment assets of $1,495,551. Therefore, Arkansas overstated the Medicare segment assets by $546,859. The accumulated overstatement of Medicare segment assets is shown in Table 1.

Table 1: Summary of Asset Adjustments	
Contributions & Prepayment Credits	111,567
Benefit Payments	(373,021)
Transfers	(229,467)
Earnings and Expenses	(55,938)
(Over)/Understatement	(546,859)

Prior Audit Recommendation

Arkansas did properly implement our prior audit[1] recommendation to decrease Medicare segment pension assets by $2,017,336 as of January 1, 1996, which adjusted Medicare segment assets to $7,094,436.

[1]We previously reviewed Arkansas's update of segment assets from January 1, 1991, to January 1, 1996 (A-07-98-02524).

Benefit Payments Understated

Arkansas understated benefit payments by $373,021 because it incorrectly identified the Medicare segment. This understatement of benefit payments results in an overstatement of the Medicare segment assets.

Contributions and Prepayment Credits Understated

Arkansas's update methodology did not equitably assign pension contributions to the Medicare segment primarily because Arkansas failed to amortize the accumulated cost deficit as required by the executed advanced agreement. This caused the differences in the assignable pension costs, resulting in differences in contribution and prepayment allocations. As a result, Arkansas understated contribution and prepayments by $111,567.

The audited contributions and prepayment credits are based on the assignable pension costs as calculated by the CMS Office of the Actuary.

The segment assets increased by $111,567 in the audited update due to differences in assigned contributions and prepayment credits. A comparison of Arkansas's and our calculations of allocated pension contributions and prepayment credits is shown in Table 2**.**

Table 2: Contributions & Prepayment Credits			
Year	**OIG**	**Arkansas**	**Difference**
1996	$1,165,203	$1,165,203	$0
1997	1,309,279	1,223,060	86,219
1998	586,193	560,845	25,348
TOTAL	**$3,060,675**	**$2,949,108**	**$111,567**

Net Transfers Understated

Arkansas understated transfers out of the Medicare segment by $229,467. It made adjustments for transfers in its update of segment assets; however, it incorrectly identified the participants who transferred in and out of the segment. As a result, Arkansas overstated its Medicare segment assets by $229,467.

A comparison of Arkansas's and our calculations of net asset transfers from the Medicare segment is shown in Table 3.

Table 3: Net Asset Transfers from the Medicare Segment			
Year	**OIG**	**Arkansas**	**Difference**
1996	137,534	(176,594)	314,128
1997	(193,893)	263,501	(457,394)
1999	(86,201)	0	(86,201)
Total	**(142,560)**	**86,907**	**(229,467)**

Earnings and Expenses Overstated

Arkansas overstated investment earnings, less administrative expenses, by $55,398 for the Medicare segment because it used incorrect contribution, prepayment credit, transfer, and benefit amounts (discussed above) to develop the Medicare asset base. In our audited update, we allocated earnings and expenses based upon the applicable CAS requirements.

EXCESS PENSION ASSETS

Cost Accounting Standards

Medicare contracts specifically prohibit any profit (gain) from Medicare activities. Therefore, according to the contract, pension gains that occur when a pension plan terminates should be credited to the Medicare program. In addition, FAR addresses dispositions of gains in situations such as pension plan termination. When excess or surplus assets revert to a contractor as a result of termination of a pension plan or such assets are constructively received by it for any reason, the contractor shall make a refund or give credit to the Government for its equitable share (FAR, section 31.205-6(j)(4)). Pension plan terminations are addressed by CAS at 9904.413-50(c)(12), which states:

> If a segment is closed, if there is a pension plan termination, or if there is a curtailment of benefits, the contractor shall determine the difference between the actuarial liability for the segment and the market value of the assets allocated to the segment, irrespective of whether or not the pension plan is terminated. The difference between the market value of the assets and the actuarial accrued liability for the segment represents an adjustment of previously-determined pension costs.
>
> (i) The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs. If there is a pension plan termination, the actuarial accrued liability shall be measured as the amount paid to irrevocably settle all benefit obligations or paid to the Pension Benefit Guarantee Corporation.
>
> (ii) . . . The market value of the assets shall be reduced by the accumulated value of prepayment credits, if any. Conversely, the market value of assets shall be increased by the current value of any unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2).
>
> (iii) The calculation of the difference between the market value of the assets and the actuarial accrued liability shall be made as of the date of the event (e.g., contract termination, plan amendment, plant closure) that caused the closing of the segment, pension plan termination, or curtailment of benefits. If such a date is not readily determinable, or if its use can result in an inequitable calculation, the contracting parties shall agree on an appropriate date.

> (iv) Pension plan improvements adopted within 60 months of the date of the event which increase the actuarial accrued liability shall be recognized on a prorata basis using the number of months the date of adoption preceded the event date. Plan improvements mandated by law or collective bargaining agreement are not subject to this phase-in.

The methodology for determining the Federal Government's share of the excess pension assets is addressed by CAS 413.50(c)(12)(vi), which states:

> The Government's share of the adjustment amount determined for a segment shall be the product of the adjustment amount and a fraction. The adjustment amount shall be reduced for any excise tax imposed upon assets withdrawn from the funding agency of a qualified pension plan. The numerator of such fraction shall be the sum of the pension plan costs allocated to all contracts and subcontracts (including Foreign Military Sales) subject to this Standard during a period of years representative of the Government's participation in the pension plan. The denominator of such fraction shall be the total pension costs assigned to cost accounting periods during those same years. This amount shall represent an adjustment of contract prices or cost allowance as appropriate. The adjustment may be recognized by modifying a single contract, several but not all contracts, or all contracts, or by use of any other suitable technique.

EXCESS TOTAL COMPANY PENSION ASSETS AS OF MAY 1, 1999

Arkansas did not calculate the excess pension assets in accordance with the CAS in determining Medicare's share of the excess pension assets as of May 1, 1999. Arkansas identified $3,880,476 in total company excess pension assets which included both the Medicare segment and Other segment excess assets. However, we calculated the total company excess to be $265,071 as of May 1, 1999. As a result, Arkansas overstated the excess total company pension assets by $3,615,405. The overstatement occurred primarily because Arkansas incorrectly included the unrecognized accumulated cost deficit. The accumulated cost deficit is not an unallowable unfunded pension cost; therefore, it is not to be included as an adjustment in the calculation of the excess pension assets or liabilities.

MEDICARE'S SHARE OF EXCESS PENSION ASSETS

Arkansas did not comply with the CAS in determining Medicare's share of the excess pension assets as of May 1, 1999. Arkansas overstated the Medicare segment's pension assets and understated the Other segment's pension liabilities. Arkansas computed and remitted to the Federal government $1,125,543 as Medicare's share of the excess pension assets; however, we determined that $1,108,832 is Medicare's share. As a result, Arkansas overstated Medicare's share of excess pension assets by $16,711 and overpaid the Federal government for its share of the excess assets.

We calculated the Medicare and Other segment's aggregate Medicare percentage (See Appendix C) and applied it to the Medicare and Other segment's total excess assets/liabilities to determine Medicare's share of the excess assets. The calculation of Medicare's share of the excess assets is shown in Table 5.

Table 5: Calculation of Medicare's Share of the Total Company Excess Assets			
Segment	Excess Asset/(Liabilities) as of May 1, 1999(A)	Aggregate Medicare Percentage(B)	Excess Assets/(Liabilities) Attributable to Medicare(AxB)
Medicare	1,363,101	87.42%	1,191,623
Other	(1,098,030)	7.54%	(82,791)
Per OIG Due to the Federal Government			1,108,832
Per AR Remitted to the Federal Government			1,125,543
Difference			(16,711)

RECOMMENDATION

We recommend that Arkansas decrease Medicare's share of the excess pension assets by $16,711, and adjust its Final Administrative Cost Proposal to properly reflect Medicare's share of the excess assets.

AUDITEE'S COMMENTS

In written comments on our draft report, Arkansas disagreed that it failed to include the excise tax as an adjustment to the calculation of the excess pension assets. Arkansas also disagreed that it failed to remit Medicare's share of the excess assets to the Federal government. Arkansas's comments are included in their entirety as Appendix D.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

After reviewing Arkansas's comments and the additional documentation provided by Arkansas, we determined that it had included the excise tax as an adjustment to the calculation of the excess assets. Additionally, we determined that Arkansas did remit $1,125,543 as Medicare's share of the excess assets to the Federal government. Therefore, we modified the audit findings and recommendation to reflect Arkansas's comments.

APPENDIXES

Arkansas Blue Cross Blue Shield
Statement of Market Value of Pension Assets
For the Period
January 1, 1996, to May 1, 1999

Description		Total Company	Other Segment	Medicare
Assets January 1, 1996	1/	$35,211,927	$28,117,491	$7,094,436
Prepayment Transfer		0	(1,165,203)	1,165,203
Contributions	2/	4,792,258	4,792,258	0
Earnings	3/	4,553,392	3,510,264	1,043,128
Benefit Payments	4/	(4,214,630)	(3,507,751)	(706,879)
Expenses	5/	0	0	0
Transfers	6/	0	(137,534)	137,534
Assets January 1, 1997		40,342,947	31,609,525	8,733,422
Prepayment Transfer	7/	0	(1,309,279)	1,309,279
Contributions		3,678,900	3,678,900	0
Earnings		3,974,369	2,984,584	989,785
Benefit Payments		(10,840,903)	(8,989,633)	(1,851,270)
Expenses		0	0	0
Transfers		0	193,893	(193,893)
Assets January 1, 1998		37,155,313	28,167,990	8,987,323
Prepayment Transfer		0	(586,193)	586,193
Contributions		2,063,254	2,063,254	0
Earnings		7,560,523	5,613,327	1,947,196
Benefit Payments		(1,583,441)	(1,469,709)	(113,732)
Expenses		0	0	0
Transfers		0	0	0
Assets January 1, 1999		45,195,649	33,788,669	11,406,980
Prepayment Transfer		0	0	0
Contributions		0	0	0
Earnings		872,514	652,299	220,215
Benefit Payments		(42,752,580)	(32,299,588)	(10,452,992)
Expenses		(551,959)	(412,649)	(139,310)
Transfers		0	86,201	(86,201)
Assets May 1, 1999		$2,763,624	$1,814,932	$948,692
Per Arkansas	8/	$2,763,624	$1,268,073	$1,495,551
Asset Variance	9/	$0	$546,859	($546,859)

FOOTNOTES

1/ We determined the Medicare segment assets as of January 1, 1996, based upon our prior segmentation audit (A-07-98-02524). The amounts shown for the other segment represent the difference between the total company and the Medicare segment. All pension assets are shown at market value.

2/ We obtained total company contribution amounts from the actuarial valuation reports and Department of Labor/Internal Revenue Service Form 5500s. We allocated total company contributions to the Medicare segment based on the ratio of the Medicare segment funding target divided by the total company funding target. Contributions in excess of the funding targets were treated as prepayment credits and accounted for in the Other segment until needed to fund pension cost in the future.

3/ We obtained investment earnings from actuarial valuation reports. We allocated investment earnings based on the market value of Medicare assets at the beginning of the plan year after adjustment for transfers. For years starting with 1996, we allocated investment earnings based on the ratio of the segment's Weighted Average Value (WAV) of assets to total company WAV of assets as required by the Cost Accounting Standards (CAS).

4/ We based the Medicare segment's benefit payments on actual payments to Medicare retirees. Arkansas provided us with supporting documentation for benefit payment amounts to plan retirees. We used actual benefit payments for Medicare segment retirees.

5/ We allocated administrative expenses to the Medicare segment in proportion to investment earnings.

6/ We identified participant transfers between segments by comparing valuation data files provided by Arkansas. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. For plan years starting with 1996, asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with the CAS.

Arkansas Blue Cross Blue Shield
Statement of Market Value of Pension Assets
For the Period
January 1, 1996, to May 1, 1999

7/ Prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current year contributions in order to reduce interest costs to the Federal Government. Prepayment credits are transferred to the Medicare segment at the first of the year as needed to cover funding requirements.

8/ We obtained total asset amounts as of May 1, 1999, from the actuarial valuation report as prepared by Arkansas's actuarial consulting firm. These final assets represent the Market Value of Assets on May 1, 1999 after payout of all termination liabilities in May, 1999. (e.g. $1,495,551 equals $11,931,869 minus $10,436,318.)

9/ The asset variance represents the difference between our calculation of Medicare segment assets and Arkansas's market value of assets.

Arkansas Blue Cross Blue Shield
Calculation of Excess Assets as of May 1, 1999

		Total Company	Other Segment	Medicare Segment
Final Market Value of Assets As May 1, 1999	1/	2,763,624	1,814,932	948,692
Prepayment Credits	2/	(5,130,080)	(5,130,080)	0
Adjusted Final Market Value of Assets		(2,366,456)	(3,315,148)	948,692
Accrued Actuarial Liabilities	3/	0	0	0
Adjustment for Plan Amendments:	4/			
3/31/1999 Amendment	5/	(145,564)	(133,301)	(12,263)
6/1/1997 Amendment	6/	(2,879,124)	(2,336,374)	(542,750)
1/1/1995 Amendment	7/	(21,427)	(19,712)	(1,715)
Adjusted Actuarial Liability		(3,046,115)	(2,489,387)	(556,728)
Excise Tax	8/	414,588	272,269	142,319
Excess Assets as of May 1, 1999	9/	265,071	(1,098,030)	1,363,101

FOOTNOTES:

1/ We obtained the final market value of assets from Appendix A.

2/ Cost Accounting Standard (CAS) 413-50(c)(12)(ii) required that the market value of the assets be reduced by the accumulated value of the prepayment credit when a segment closed, pension plan terminated, or a curtailment of benefits occurred.

3/ Arkansas paid out all of the accrued benefits to the plan participants on May 1, 1999; therefore, the actuarial liability for the pension plan was $0.

4/ CAS 413-50(c)(12)(iv) required that pension plan improvements adopted within 60 months of the date of the event (plan termination), which increase the actuarial accrued liability, shall be recognized on a prorated basis using the number of months that the date of adoption preceded the event date.

5/ Plan amendment on March 31, 1999 was a three percent increase in the retiree cost of living adjustment.

6/ Pension plan amendment on June 1, 1997 offered a voluntary Retirement Program to all eligible participants from February 10, 1997 to March 31, 1997. The benefit calculation is based on service to May 31,1997. The Program adds five years to age when computing early retirement reductions and five years to service for computing the benefit amount.

7/ Pension plan amendment on January 1, 1995 was a six percent increase in the retiree cost of living adjustment.

8/ Excise tax was paid by Arkansas due to reversion of pension fund assets to Arkansas resulting from the termination of the pension plan. The excise tax reduced the surplus prior to the determination of the reversion due to the Government. It was allocated to the Medicare segment based on the ratio of the Medicare Segment Final Market Value of Assets to the Total Company Final Market Value of Assets.

9/ We calculated the excess assets/liabilities due to the pension plan termination based upon the required adjustments. The excess assets represent the adjusted final market value of assets less the adjusted accrued actuarial liability and excise tax.

Arkansas Blue Cross Blue Shield **APPENDIX C**

Calculation of the Aggregate Medicare Percentage

Medicare Segment Aggregate Medicare Percentage			
Fiscal Year	**Total Medicare Segment Pension Costs**	**Pension Costs Claimed for Medicare Reimbursement**	**Aggregate Percentage**
1991	473,954	423,810	89.42%
1992	711,212	585,541	82.33%
1993	800,176	646,542	80.80%
1994	917,726	733,997	79.98%
1995	952,066	805,067	84.56%
1996	976,320	881,422	90.28%
1997*	1,409,034	1,312,656	93.16%
1998	766,965	737,207	96.12%
Total	**7,007,453**	**6,126,242**	**87.42%**

Other Segment Aggregate Medicare Percentage			
Fiscal Year	**Total Other Segment Pension Costs**	**Pension Costs Claimed for Medicare Reimbursement**	**Aggregate Percentage**
1991	734,675	123,058	16.75%
1992	1,068,613	132,829	12.43%
1993	1,363,217	166,721	12.23%
1994	1,435,524	109,674	7.64%
1995	1,774,888	129,744	7.31%
1996	2,275,587	113,097	4.97%
1997	3,333,205	163,660	4.91%
1998	1,971,472	113,951	5.78%
Total	**13,957,181**	**1,052,734**	**7.54%**

* The pension costs for 1997 include additional pension costs attributable to calendar year (CY) 1996 due to an Advance Agreement between CMS and Arkansas that approved additional costs to the CY 1996 pension costs. The parties agreed, based upon the revised CAS, that previously unfunded unallowable pension costs which had been excluded from the calculation of the CAS pension costs were now reassignable unfunded pension costs. Beginning as of January 1, 1996, those reassignable unfunded pension costs would be amortized over 10 years; thus they would now be included as a component of the CAS pension costs. This cost is allowable in the fourth quarter of CY 1996 since the January through September pension costs have been reported in the prior costs claimed report (A-07-98-02525) and are closed.

Arkansas
BlueCross BlueShield

601 S. Gaines St.
P.O. Box 2181
Little Rock, Arkansas 72203-2181

March 14, 2007

Patrick J. Cogley
Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Inspector General
Offices of Audit Services
Region VII
601 East 12th Street, Room 284A
Kansas City, MO 64108

Subject: Report Number: A-07-06-00206

Dear Mr. Cogley:

On behalf of Dan Bloodworth, Chief Financial Officer of Pinnacle Business Solutions, Inc., I am responding to the draft report entitled "Review of Medicare Contractor's Pension Segmentation Requirements at Arkansas Blue Cross and Blue Shield and Pension Plan Termination". I have been in communication with Megan Seehafer and Jenenne Tambke regarding this report and want to express my appreciation to them for allowing me the extended time to respond due to other on-going audits here in Arkansas.

The finding indicated that Arkansas Blue Cross and Blue Shield (ABCBS) had not returned to the Medicare program the $1,324,168 share of excess pension assets offset by an overstatement of $215,336. This overstatement was the result of our incorrectly including the unrecognized accumulated cost deficit and failing to include the excise tax as adjustments to the calculation of excess assets.

ABCBS applied the credit for excess pension assets to the Medicare program in December, 1999 (FY 2000), as an offset to the successor defined contribution plan – our 401K Plu$ plan. This was in the full amount of $1,324,168. Additionally, we charged Medicare, also in December, 1999 with the associated excise tax of $22,971.67 and $175,653.50 for Part A and Part B, respectively.

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Response to Draft Audit Report
March 14, 2007

I have enclosed schedules for both Part A and Part B reflecting both the excess pension assets credit and the excise tax expense as part of the Final Administrative Cost Proposal (FACP) for FY 2000. I believe you will see that all amounts were applied to the cost of our government programs at the earliest time following the final distribution of assets to the participants. While there were some adjustments to the 401K Plu$ accounts filed as part of the FACP, they represent adjustments to actual amounts for both FY 1999 and FY 2000. The calendar year plan calls for contributions to be made in March of the following calendar year so fiscal year adjustments are always necessary.

Based on this, ABCBS has given $16,711 too much credit to the Federal Government due to the termination of our pension plan. Our net return to Medicare was $1,125,543 ($1,324,168 in excess assets minus $198,625 in excise tax) versus the requested amount of $1,108,832.

I am not submitting a corrective action plan since this report is for the termination of the pension plan and thus no further reporting of defined benefit pension plan costs will occur.

I will forward a soft copy of the worksheets to Jenenne via e-mail.

Again, it has been a pleasure to work with Megan and Jenenne during this audit and we look forward to a final closing agreement in the near future. Should you need anything further, please let me know.

Sincerely,

Beverly C. Villines

Beverly C. Villines, Director
Corporate Accounting
Arkansas Blue Cross and Blue Shield

cc: Dan Bloodworth, Sr. Vice President and
Chief Financial Officer
Pinnacle Business Solutions, Inc.