

**Memorandum**

Date MAR 30 1999

From June Gibbs Brown
Inspector General *June G Brown*

Subject Audit of the Pension Plan at a Terminated Medicare Contractor, Blue Shield of California
(A-07-98-02522)

To Nancy-Ann Min DeParle
Administrator
Health Care Financing Administration

This is to alert you to the issuance of our final audit report on April 1, 1999, identifying about \$7.6 million in excess pension assets at Blue Shield of California (California) which should be remitted to Medicare because of the closing of California's Medicare segment of its pension plan. A copy is attached and copies of the report have been distributed to your staff for adjudication of the finding.

California was a Medicare Part B contractor until its contract was terminated in 1996, and, as such, claimed Medicare reimbursement for Medicare employees' pension costs. Regulations and the Medicare contract provide, however, that pension gains attributable to the Medicare segment of a pension plan at a terminated contractor should be credited to the Medicare program. Accordingly, we are recommending that California remit about \$7.6 million in excess pension assets to the Medicare program. California agreed with our finding and recommendation.

If you need additional information about this report, please contact Barbara A. Bennett, Regional Inspector General for Audit Services, Region VII, 816-426-3591.

Attachment

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF THE PENSION PLAN AT A
TERMINATED MEDICARE
CONTRACTOR, BLUE SHIELD OF
CALIFORNIA**



**JUNE GIBBS BROWN
Inspector General**

**MARCH 1999
A-07-98-02522**



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

CIN A-07-98-02522

Ms. Karen Schievelbein
Senior Vice President, Chief Financial Officer
Blue Shield of California
50 Beale Street
San Francisco, California 94105-1808

Dear Ms. Schievelbein:

This report provides the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Audit of the Pension Plan at a Terminated Medicare Contractor, Blue Shield of California*. The purpose of our review was to determine the excess assets that should be remitted to Medicare by Blue Shield of California (California) because of the termination of the Medicare contractual relationship in 1996.

We computed excess Medicare pension assets of \$7,623,524 as of November 30, 1996, which California should remit to the Federal government. California agreed with our finding, but requested that they be allowed to remit the excess Medicare pension assets over a 10 year period. California's response is included in its entirety as Appendix A.

INTRODUCTION

BACKGROUND

California administered Medicare Part B operations under cost reimbursement contracts. In claiming costs, contractors were to follow cost reimbursement principles contained in the Federal Procurement Regulations (FPR), which were superseded by the Federal Acquisition Regulations (FAR), the Cost Accounting Standards (CAS), and the Medicare contract.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. These payments represent allowable pension costs under the FPR and/or the FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

The CAS 412 regulates the determination and measurement of the components of pension costs. 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 Health Care Financing Administration (HCFA) incorporated segmentation requirements into Medicare contracts starting with Fiscal Year 1988. The contractual language specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment.

The Medicare contract defines a segment, and specifies the methodology for the identification and initial allocation of pension assets to the Medicare segment. Furthermore, the contract requires that the Medicare segment assets be updated for each year after the initial allocation in accordance with CAS 413.

In our report titled "*Audit of Medicare Contractor's Pension Segmentation, Blue Shield of California*", dated February 1, 1994 (CIN A-07-92-00585) we addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1986, and updated the segment's assets to January 1, 1991.

California's Medicare Part B contract was terminated effective November 30, 1996. Consequently, the majority of California's Medicare segment employees were terminated and the Medicare segment was closed on that date. Contract terminations and segment closings are addressed by CAS at 9904.413-50(c)(12), which states:

"If a segment is closed, ..., the contractor shall determine the difference between the actuarial accrued 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....

(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.... 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."

Medicare contracts specifically prohibit any profit (gain) from Medicare activities. Therefore, according to the contract, pension gains which occur when a Medicare segment terminates should be credited to the Medicare program. In addition, FAR addresses dispositions of gains in

situations such as segment closings. When excess or surplus assets revert to a contractor as a result of termination of a defined benefit 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)).

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine the amount of excess assets that should be remitted to Medicare as a result of the contract termination and Medicare segment closing. Achieving the objective did not require a review of California's internal control structure.

California's Medicare contract was terminated and the Medicare segment was closed on November 30, 1996. Accordingly, we agreed with California that November 30, 1996 would be an appropriate settlement date for the closing of the segment. We therefore reviewed California's identification of the Medicare segment and its update of Medicare assets from January 1, 1991 to November 30, 1996.

We performed this review in conjunction with our audit of pension costs claimed for Medicare reimbursement (CIN A-07-98-02523). The information obtained and reviewed during that audit was also used in performing this review.

In performing the review, we used information provided by Watson Wyatt Worldwide, California's consulting actuary. The information included liabilities, normal costs, contributions, and earnings. We reviewed California's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, we verified California's update of Medicare segment assets to November 30, 1996. The HCFA pension actuarial staff reviewed our methodology and calculations.

Site work at California's corporate offices in San Francisco, California was performed during July and October 1998. We performed subsequent audit work in our OIG, OAS Jefferson City, Missouri field office.

FINDING AND RECOMMENDATION

When California's Medicare segment closed, Medicare's share of the excess pension assets was \$7,623,524, which we are recommending be remitted to HCFA. To determine Medicare's share it was necessary to (1) update segment assets to November 30, 1996 and (2) calculate the actuarial liability for accrued benefits for the segment, and the excess Medicare assets.

As of November 30, 1996, California identified Medicare segment assets of \$17,043,477. Additionally, California identified the Medicare segment's actuarial liability for accrued benefits as \$9,419,953.

We reviewed California's update of Medicare segment assets to November 30, 1996. We also reviewed California's calculation of the Medicare segment's actuarial liability for accrued benefits as of November 30, 1996. We agree with California's determination of both amounts. Therefore we computed Medicare's share of excess pension assets to be \$7,623,524 (\$17,043,477 less \$9,419,953) as of November 30, 1996.

Recommendation:

We recommend that California:

Remit \$7,623,524 to the Health Care Financing Administration.

Auditee Response

California agreed with our finding and recommendation, but requested that they be allowed to remit the excess Medicare pension assets over a 10 year period. California's response is included in its entirety as Appendix A.

OIG Comments

Terms and conditions for the remittance of the excess Medicare pension assets are determined by HCFA.

INSTRUCTIONS FOR AUDITEE RESPONSE

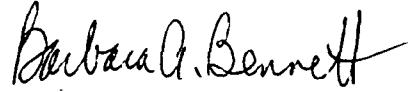
Final determinations as to actions to be taken on all matters reported will be made by the HHS action official identified below. We request that you respond to the recommendation in this report within 30 days from the date of this report to the HHS action official, presenting any comments or additional information that you believe may have a bearing on final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS, reports issued to the Department's grantees and contractors are made available, if

Page 5 - Ms. Karen Schievelbein

requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise.
(See 45 CFR Part 5).

Sincerely,

A handwritten signature in black ink that reads "Barbara A. Bennett". The signature is written in a cursive style with a long horizontal flourish extending to the right.

Barbara A. Bennett
Regional Inspector General for
Audit Services, Region VII

HHS Action Official:

Elizabeth C. Abbott
Regional Administrator, Region IX
Health Care Financing Administration
75 Hawthorne Street, 4th Floor
San Francisco, CA 94105

Karen Schievelbein
Senior Vice President
Chief Financial Officer

January 26, 1999

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

RE: CIN: A-07-98-02522

Dear Ms. Bennett

I have reviewed the draft report of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Audit of the Pension Plan at a Terminated Medicare Contractor, Blue Shield of California*, dated December 30, 1998. In the interest of expediency we will accept the draft report's recommendations and are prepared to remit the amount recommended.

However, for the reasons given below, we request that you take into consideration a modification to your recommendation concerning the timing of payment.

You reference in your report the FAR section that addresses the disposition of gains in the situation of a segment closing which states, "When excess or surplus assets revert to a contractor as a result of termination of a defined benefit 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))." In our situation, the surplus assets did not revert to, nor were funds constructively received by, Blue Shield of California due to this segment closing. The Medicare activities were a segment within the referenced pension plan. And as such, at the time the Blue Shield of California's Medicare contract was terminated, the terminations related to the closing of this segment did not constitute a "plan termination" and the over-funding of the pension plan remained in the Pension Fund and were not constructively received by Blue Shield of California, the contractor. Under ERISA, funds (including any gains resulting in over-funding of the plan) cannot be withdrawn from the plan by the employer sponsor. Under FAS 87, the guidance for pension accounting for employers, the delayed recognition feature requires that changes in the pension obligation (including those resulting from plan amendments) and changes in the value of assets set aside to meet those obligations (including gains) are not recognized as they occur but are recognized systematically and gradually over subsequent periods.

Given the funds requested cannot be transferred from the Pension Account in which they are held and given the delayed recognition accounting treatment for financial reporting and recognition of the over-funding, I am requesting you take into consideration a modification to your recommendation to allow for the transfer of the over-funded pension assets by Blue Shield of California to the Health Care Financing Administration (HCFA) in the amount of \$762,352.40 per year for a period of ten years.

Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read "Karen Schievelbein". The signature is fluid and cursive, with the first name "Karen" written in a larger, more prominent script than the last name "Schievelbein".

Karen Schievelbein

cc: Wayne Moon, Blue Shield of California, Chairman and CEO
Seth Jacobs, Blue Shield of California, Senior Vice President and General Counsel