Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF MEDICARE CONTRACTOR'S PENSION SEGMENTATION, BLUE CROSS AND BLUE SHIELD ASSOCIATION

JUNE GIBBS BROWN
Inspector General

MARCH 1999
A-07-98-02527

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

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

CIN: A-07-98-02527

MAR 10 1999

Mr. Ralph D. Rambach
Vice-President, Finance and Administration
Blue Cross and Blue Shield Association
225 North Michigan Avenue, 5th Floor
Chicago, Illinois 60601-7680

Dear Mr. Rambach:

This report provides the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Medicare Contractor's Pension Segmentation, Blue Cross and Blue Shield Association*. The purpose of our review was to evaluate Blue Cross and Blue Shield Association's (the Association) compliance with the pension segmentation requirements of its Medicare contract. The audit addressed the update of pension assets during the period January 1, 1994 to January 1, 1997.

Our review showed that the Association overstated Medicare segment assets as of January 1, 1994 by $57,343. The overstatement occurred because the Association did not implement the recommendations of our prior segmentation audit report. The Association update of the Medicare segment assets from 1994 to 1997 overstated segment assets by an additional $349,700. The overstatement occurred primarily because the Association used incorrect participant data in their update of pension assets, and computed transfer adjustments for 1996 using an incorrect actuarial liability.

We recommend that the Association decrease the January 1, 1997 assets of the Medicare segment by $407,043 ($57,343 plus $349,700). The Association accepted our recommendation and its response is included as Appendix B.

INTRODUCTION

BACKGROUND

The Association has administered Medicare Part A under cost reimbursement contracts since the start of the Medicare program. The contracts, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations (FPR), and the Cost Accounting Standards (CAS) contain reimbursement principles for cost reimbursement contracts.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plan. These payments represented 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 Association's contract required: (1) computing the Medicare segment's actuarial liability, (2) determining the ratio of the Medicare segment's actuarial liability to the total plan actuarial liability (asset fraction), (3) allocating a portion of total pension assets as of 1986 based on the above ratio, (4) updating Medicare pension assets annually, and (5) assessing if Medicare's pension costs should be separately calculated.

The Medicare contracts identify a Medicare segment as:

> *...any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:*
>
> *1. The majority of the salary dollars is allocated to the Medicare contract/agreement; or*
>
> *2. Less than a majority of the salary dollars is allocated to the Medicare contract/agreement, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare contract/agreement.*

The contracts also provide for separate identification of the pension assets of the Medicare segment. The identification involves the allocation of assets to the Medicare segment as of the first pension plan year after December 31, 1985 in which the salary criterion was met. The allocation was to use the ratio of the actuarial liabilities of the Medicare segment to the actuarial liabilities of the total plan, as of the later of the first day of the first plan year starting after December 31, 1980, or the first day of the first pension plan year following the date such Medicare segment first existed.

Our previous segmentation review (CIN: A-07-94-01103) addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1986, and the update of the segment's assets to January 1, 1994.

In reports provided for our current review, the Association identified total pension assets of $88,703,613 and Medicare segment assets of $7,707,396 as of January 1, 1997. The Association also concluded that separate valuations for the Medicare segment were required.

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine the Association's compliance with pension segmentation requirements of its Medicare contract. Achieving our objective did not require that we review the internal control structure of the Association. The audit addressed the update of pension assets during the period January 1, 1994 to January 1, 1997.

We performed this review in conjunction with our audit of overfunded pension costs (CIN: A-07-98-02528). The information obtained and reviewed during that audit was also used in performing this review.

We reviewed the Association's identification of the Medicare segment and its update of Medicare assets from January 1, 1994 to January 1, 1997.

In performing the review, we used information provided by the Association's consulting actuarial firm. The information included liabilities, normal costs, contributions, benefit payments, expenses, and earnings. We reviewed the Association's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, we updated the Medicare segment assets to January 1, 1997. The HCFA pension actuarial staff reviewed our methodology and calculations.

We performed site work at the Association's corporate offices in Chicago, Illinois during April 1998. Subsequently, we preformed audit work in our Jefferson City, Missouri office.

FINDING AND RECOMMENDATION

As of January 1, 1997 pension assets for the Association's Medicare segment were overstated by $407,043. The overstatement occurred because the Association did not implement the audit recommendation contained in our previous audit report ($57,343), made incorrect transfer adjustments from the Medicare segment and computed transfer adjustments for the end of plan year 1996 using an incorrect actuarial liability ($227,300), and incorrectly allocated investment earnings and expenses ($122,400).

Prior Audit Recommendations

We determined that the Association's calculations overstated the January 1, 1994 Medicare segment assets by $57,343. The overstatement occurred because the Association did not implement the recommendation contained in our previous segmentation report (CIN: A-07-94-01103). During our current review the Association acknowledged that they concurred with the finding and recommendation of our previous segmentation report. However, the Association's consulting actuary had not implemented the report recommendation in the Association's segment calculations.

The following schedule shows the details of the calculations.

	The Association	OIG	Variance
January 1, 1994 Medicare Segment Assets	$5,699,607	$5,642,264	$57,343

Participant and Transfers

In the update of pension assets, the Association misidentified Medicare segment participants. The Association incorrectly included participants in non-Medicare cost centers and incorrectly excluded participants in Medicare segment cost centers. Since the identification of participants was incorrect, transfers (representing the movement in and out of the segment each year) in the updates were also incorrect. Additionally , the Association computed their adjustments for the end of plan year 1996 using an incorrect actuarial liability.

In accordance with the revised CAS, codified at CFR 9904.413-50(c)(8), "If assets and liabilities are transferred, the amount of assets transferred shall be equal to the actuarial accrued liabilities, determined using the accrued benefit cost method (ABCM), transferred." The revised CAS became effective to the Association with their Plan year commencing on January 1, 1996. Therefore, the transfer adjustments computed for the end of plan year 1996 should have been based on the participants' actuarial liability determined under the ABCM.

In comparison, the Association's and our computations of transfer amounts were as follows:

Transfer Adjustments to the Medicare Segment

Year	OIG	Association
1994	($44,607)	$104,169
1995	($123,968)	($206,014)
1996	($92,380)	$68,190
Total	($260,955)	($33,655)

We corrected the identification of the segment participants and transfer amounts in updating the Medicare segment pension assets. Additionally, our computation of transfer adjustments used the accrued actuarial liability determined under the ABCM, as estimated by the HCFA Office of the Actuary, for plan year 1996. See Appendix A. Our corrections to the transfer amounts decreased the Medicare segment assets by $227,300 ($260,955 less $33,655).

Earnings and Expenses

The Association's update methodology allocated investment earnings and expenses to the Medicare segment based on the ratio of the beginning of year market value of Medicare assets to beginning of year market value of total assets. Because the Association's asset amounts were incorrect, it overstated the segment's earnings and expenses for each year of the update. Except for correcting asset amounts, as previously described, we used the Association's allocation methodology in our update and decreased the Medicare segment assets by $122,400.

MEDICARE ASSETS AS OF JANUARY 1, 1997

We updated pension assets of the Medicare segment from January 1, 1994 to January 1, 1997 (See Appendix A). Our calculation showed the assets of the Medicare segment decreased $407,043 as of January 1, 1997. The decrease resulted from starting with the proper assets as of January 1, 1994 ($57,043 decrease), correcting the transfer adjustments ($227,300 decrease) and calculating the update with corrected asset amounts ($122,400 decrease).

Recommendation:

We recommend that the Association:

- Decrease the pension assets of the Medicare segment by $407,043 as of January 1, 1997.

Auditee Response

The Association accepted our recommendation.

INSTRUCTION FOR AUDITEE RESPONSE

Final determination as to actions to be taken on all matters reported will be made by the HHS actions official identified on the following page. We request that you respond to each of the recommendations in this report within 30 days from the date of this report to the 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 requested, to members of the press and general public to the extent information contained therin is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5)

Sincerely,

Barbara A. Bennett

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

Enclosures

BLUE CROSS AND BLUE SHIELD ASSOCIATION
CHICAGO, ILLINOIS

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD
JANUARY 1, 1994 TO JANUARY 1, 1997

Description		Total Company	Other Segment	Medicare Segment
Assets January 1, 1994	1/	**$69,020,905**	**$63,378,640**	**$5,642,265**
Contributions	2/	0	0	0
Earnings	3/	387,143	355,495	31,648
Benefits	4/	(3,552,507)	(3,552,507)	0
Expenses	5/	(357,993)	(328,728)	(29,265)
Participant Transfers	6/	0	44,607	(44,607)
Assets January 1, 1995		**$64,497,548**	**$59,897,507**	**$5,600,041**
Contributions		0	0	0
Earnings		17,106,750	15,644,123	1,462,627
Benefits		(2,139,163)	(2,139,163)	0
Expenses		(298,197)	(272,701)	(25,496)
Participant Transfers		0	123,968	(123,968)
Assets January 1, 1996		**$80,166,938**	**$73,253,734**	**$6,913,204**
Contributions		0	0	0
Earnings		12,630,636	11,560,627	1,070,009
Benefits		(3,694,672)	(3,138,018)	(556,654)
Expenses		(399,289)	(365,463)	(33,826)
Participant Transfers		0	92,380	(92,380)
Assets January 1, 1997		**$88,703,613**	**$81,403,260**	**$7,300,353**
Assets Per Association	7/	**$88,703,613**	**$80,996,217**	**$7,707,396**
Asset Variance	8/	**$ 0**	**$ 407,043**	**$ (407,043)**

BLUE CROSS AND BLUE SHIELD ASSOCIATION
CHICAGO, ILLINOIS

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD
JANUARY 1, 1994 TO JANUARY 1, 1997

FOOTNOTES

1/ We calculated the January 1,1994 Medicare segment assets during our previous segmentation review. The amounts shown for the other segment represent the difference between the total company and the Medicare segment.

2/ We obtained total contribution amounts from IRS Form 5500 reports. The Association did not make contributions to the pension trust fund for the years 1994 through 1997, because the plan was overfunded.

3/ The Association provided earnings amounts and we verified them to IRS Form 5500 reports. We allocated earnings to the Medicare segment based on the ratio of beginning of year market value of Medicare assets to the beginning of year market value of total assets. The Association used this same methodology.

4/ The Association provided benefit payment amounts and we verified them to IRS Form 5500 reports. We used actual benefit payments for Medicare segment retirees.

5/ The Association provided administrative expense amounts and we verified them to IRS Form 5500 reports. We allocated administrative expenses to the Medicare segment on the ratio of beginning of year market value of Medicare assets to the beginning of year market value of total assets. The Association used this same methodology.

6/ We identified participant transfers between segments by comparing annual participant valuation listings provided by the Association. The listings contained the actuarial liability of each participant at year-end. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. We calculated the funding level as the assets divided by the liabilities. If the funding level ratio was greater than one, we transferred assets equal to the participant's liability. The Association used this same methodology.

7/ We obtained the total asset amounts as of January 1, 1997 from the Association's update of assets provided by its actuary.

8/ The asset variance represents the difference between the OIG calculation of assets as of January 1, 1997 and the assets calculated by the Association's actuary.

BlueCross BlueShield Association

An Association of Independent Blue Cross and Blue Shield Plans

Ralph D. Rambach
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February 12, 1999

Barbara A. Bennett
Regional Inspector General for
Audit Services, Region VII
Department of Health & Human Services
Office of Audit Services
610 East 12th Street
Kansas City, MO 64106

Re: CIN A-07-98-02527
CIN A-07-98-02528

Dear Ms. Bennett:

In response to your letters dated September 2, 1998, regarding the draft audit reports of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled "Review of Medicare Contractor's Overfunded Pension Plan, Blue Cross and Blue Shield Association" and "Review of Medicare Contractor's Pension Segmentation, Blue Cross and Blue Shield Association", for the period beginning January 1, 1994 to January 1, 1997, please be advised that we accept the audit recommendations and have undertaken the following steps to implement them:

> **RE: A-07-98-02528** – We have identified $710,699 as an assignable cost credit, attributable to the Medicare segment, as of January 1, 1996, and will begin amortizing the credit over a ten year period. In addition, we will identify any negative CAS costs for any subsequent years as an assignable cost credit and amortize them over a ten year period.

> **RE: A-07-98-02527** – We have decreased the January 1, 1997 pension assets of the Medicare segment by $407,043.

Sincerely,

Ralph D. Rambach
Vice President, Finance & Administration