



Office of Audit Services
Region VII
601 East 12th Street, Room 284A
Kansas City, MO 64106
(816) 426-3591

April 29, 2003

Report Number: A-07-02-03030

Mr. Christopher Woodfin
Vice President of Finance
Blue Cross and Blue Shield of North Carolina
P.O. Box 2291
Durham, North Carolina 27702-2291

Dear Mr. Woodfin:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General, Office of Audit Services' (OAS) report entitled "Blue Cross and Blue Shield of North Carolina Pension Costs Claimed for Medicare Reimbursement." A copy of this report will be forwarded to the action official noted below for his/her review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. 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, OAS reports issued to the Department's grantees and contractors are made available 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.) As such, within ten business days after the final report is issued, it will be posted on the Internet at <http://oig.hhs.gov>.

To facilitate identification, please refer to Report Number A-07-02-03030 in all correspondence relating to this report.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James P. Aasmundstad".

James P. Aasmundstad
Regional Inspector General
for Audit Services

Enclosures – as stated

Directly Reply to HHS Action Official:

Rose Crum-Johnson
Regional Administrator, Region IV
Centers for Medicare & Medicaid Services
Sam Nunn Atlanta Federal Center
4th Floor 61 Forsyth Street, SW Suite 4T20
Atlanta, GA 30303

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**BLUE CROSS AND BLUE SHIELD
OF NORTH CAROLINA PENSION
COSTS CLAIMED FOR MEDICARE
REIMBURSEMENT**



**JANET REHNQUIST
INSPECTOR GENERAL**

**APRIL 2003
A-07-02-03030**

Office of Inspector General □

<http://oig.hhs.gov/>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

Office of Audit Services

The OIG's Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the Department.

Office of Evaluation and Inspections

The OIG's Office of Evaluation and Inspections (OEI) conducts short-term management and program evaluations (called inspections) that focus on issues of concern to the Department, the Congress, and the public. The findings and recommendations contained in the inspections reports generate rapid, accurate, and up-to-date information on the efficiency, vulnerability, and effectiveness of departmental programs.

Office of Investigations

The OIG's Office of Investigations (OI) conducts criminal, civil, and administrative investigations of allegations of wrongdoing in HHS programs or to HHS beneficiaries and of unjust enrichment by providers. The investigative efforts of OI lead to criminal convictions, administrative sanctions, or civil monetary penalties. The OI also oversees State Medicaid fraud control units, which investigate and prosecute fraud and patient abuse in the Medicaid program.

Office of Counsel to the Inspector General

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. The OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within the Department. The OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops model compliance plans, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

Notices

**THIS REPORT IS AVAILABLE TO THE PUBLIC
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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 information contained therein 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 awarding agency will make final determination on these matters.





DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

April 29, 2003

Report Number: A-07-02-03030

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

Mr. Christopher Woodfin
Vice President of Finance
Blue Cross and Blue Shield of North Carolina
P.O. Box 2291
Durham, North Carolina 27702-2291

Dear Mr. Woodfin:

This report provides the results of an Inspector General (OIG), Office of Audit Services (OAS) review titled *Blue Cross and Blue Shield of North Carolina Pension Costs Claimed for Medicare Reimbursement*. The purpose of our review was to determine the allowability of pension costs claimed for Medicare reimbursement for Fiscal Years 1992 through 2001.

For Fiscal Years (FY) 1992 through 2001, we determined that Blue Cross and Blue Shield of North Carolina (North Carolina) under claimed allowable Medicare pension costs. During this period, the allowable Medicare pension costs were \$3,666,767. However, North Carolina claimed pension costs of \$2,794,032 for Medicare reimbursement. As a result, North Carolina did not claim \$872,735 in allowable pension costs. This under claim was the result of North Carolina making erroneous adjustments to the retirement account and not including indirect costs in the earlier years. We recommend that North Carolina revise its Final Administrative Cost Proposals (FACPs) for FYs 1992 through 2002 to claim additional allowable CAS pension costs of \$872,735.

North Carolina generally agreed with the conclusion that it did not claim all allowable pension costs for FYs 1992 through 2002. However, they didn't agree with certain aspects of our calculations. North Carolina's response is included in its entirety as Appendix B.

INTRODUCTION

BACKGROUND

North Carolina administered Medicare Part A under cost reimbursement contracts until the contractual relationship terminated October 31, 2001. Medicare contractors must follow cost reimbursement principles contained in the Cost Accounting Standards (CAS), the Federal Acquisition Regulations (FAR), and their Medicare contracts.

Medicare reimburses its portion of contractors' annual pension costs. To be allowable for Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with CAS 412, and 413, and (2) funded as specified by part 31 of the FAR.

The CAS addresses the stability between contract periods and requires consistent measurement and assignment of pension costs to contract periods. The CAS costs allowable as charges to Medicare include (1) the normal costs and (2) the amortization of the unfunded actuarial liability. The FAR addresses allowability of pension costs and requires that pension costs assigned to contract periods be substantiated by funding.

Additionally, the Centers for Medicare and Medicaid Services (CMS), formerly the Health Care Financing Administration, incorporated specific segmentation language into Medicare contracts. The contracts provide for either an allocation or a separate calculation of pension costs. Under an allocation method, a contractor determines total plan CAS costs and allocates a share to Medicare. Under the separate calculation method, a contractor separately identifies the normal costs and amortization for the Medicare segment. The separate calculation method must be used if there is a material difference between the two methods.

OBJECTIVES, SCOPE AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine the allowability of pension costs claimed for FY's 1992 through 2001. Achieving this objective did not require a review of North Carolina's internal control structure.

This audit was done in conjunction with our audit of pension segmentation (Report Number: A-07-02-3017). The information obtained and reviewed during that audit was also used in this audit.

We identified North Carolina's CAS pension costs for the total company and for the Medicare segment. We also determined the extent to which North Carolina funded the CAS pension costs with contributions to the pension trust fund. Using this information, we calculated CAS pension costs that are allowable for Medicare reimbursement for FY's 1992 through 2001. Appendix A contains the details for pension costs and contributions.

The CMS office of Actuary developed the methodology used for computing allowable CAS pension costs based on North Carolina's historical practices. We performed on site work at North Carolina's corporate offices in Durham, North Carolina during May of 2002. We performed subsequent audit work in our OIG OAS Kansas City, Missouri field office.

FINDINGS AND RECOMMENDATIONS

For FY’s 1992 through 2002, North Carolina did not claim \$872,735 in pension costs that were allowable for Medicare reimbursement. The pension costs are allowable because the funded portion of CAS computed costs exceeded the costs claimed. The under claim occurred primarily because North Carolina made erroneous adjustments to the retirement account. Additionally, North Carolina did not claim pension costs for indirect operations until 1994. North Carolina should revise its FACPs to reflect the additional CAS pension costs that were allowable for reimbursement.

We calculated the allowable CAS pension costs for the Medicare segment and for Medicare indirect operations. The calculations were based on separately computed CAS pension costs for the Medicare segment and total company CAS pension costs. See Appendix A for details.

We compared our calculated CAS pension costs to the pension costs claimed on North Carolina’s FACPs and found:

PENSION COST CLAIMED VARIANCE			
YEAR	PER OIG	PER NC	DIFFERENCE
1992	\$334,166	\$352,797	(\$18,631)
1993	383,278	225,139	158,139
1994	350,280	233,361	116,919
1995	382,183	162,056	220,127
1996	489,720	499,228	(9,508)
1997	502,835	407,426	95,409
1998	463,870	429,924	33,946
1999	598,927	321,032	277,895
2000	161,508	171,007	(9,499)
2001	0	(10,948)	10,948
2002	0	3,010	(3,010)
	<u>\$3,666,767</u>	<u>\$2,794,032</u>	<u>\$872,735</u>

For 1992 through 2002, North Carolina claimed pension costs of \$2,794,032 for Medicare reimbursement. However, the allowable CAS pension costs were \$3,666,767. As a result, North Carolina could have claimed \$872,735 in additional CAS pension costs.

Recommendation

We recommend that North Carolina revise its FACPs for FYs 1992 through 2002 to claim additional allowable CAS pension costs of \$872,735.

Auditee Response

North Carolina's comments are summarized in the following paragraphs and its response is included in its entirety as Appendix B.

North Carolina asserts that our cost calculations included an incorrect amount for the actuarial value of assets as of January 1, 2001. According to North Carolina, the actuarial value of assets should have been \$198,786,755 as of January 1, 2001. North Carolina also asserts that if we had used the correct actuarial value of assets in our cost calculations the allowable pension costs for FY 2001 and 2002 would have been \$0.

North Carolina believes that we may have failed to include allowable administrative costs in our computation of allowable pension costs. North Carolina noted that our prior audit report (CIN A-07-93-00685) did quantify the administrative costs.

North Carolina contends that we incorrectly calculated the investment expenses in determining the investment return of the pension fund. North Carolina stated:

“In determining the investment return of the asset fund in 1993, 1994, and 1996 the auditors assumed that investment expenses were paid at the end of the year. We believe that the investment expenses would have occurred evenly throughout the year and they should have received a mid-year weighting”

North Carolina also contends that the method we used to develop prepayment credits was inconsistent with the method that we used in our prior audit (CIN A-07-93-00685).

Subsequent to its response to the draft report, North Carolina provided information identifying additional pension costs of \$237,553 that were claimed for 1999 through 2002.

OIG Response

We agree with North Carolina's assertion that we incorrectly calculated the actuarial value of assets for the total company as of January 1, 2001. However, we determined that the correct asset value should be \$201,354,661. We also agree with North Carolina's assertion that the allowable pension costs for FYs 2001 and 2002 should be \$0.

We acknowledge that we did not quantify administrative costs and include them in our allowable cost computations. The administrative costs were not within the scope of our review. For comparison purposes, we removed the administrative costs from the pension costs that North Carolina claimed on the FACP. Therefore, we are comparing allowable CAS pension costs per the OIG to the CAS pension costs claimed by North Carolina.

We adjusted the CAS pension costs claimed by North Carolina to reflect the \$237,553 in additional costs claimed for 1999 through 2002.

We disagree with North Carolina's contention that our computations assumed that investment expenses were paid at the end of the year. Our calculations utilized the same weighted average methodology that North Carolina proposed.

Although we agree with North Carolina's contention that we were inconsistent with our development of prepayment credits, this change in methodology for prepayment credits between the current and prior audit was intentional. As noted by the CMS Office of Actuary:

“In the draft report, prepayment credits are not allocated to the Medicare segment until needed to cover a subsequent year's pension cost. Since prepayment credits are subtracted from both the Medicare segment assets and “other” segment assets for cost calculation purposes, the two methods will produce very similar results. However, the revised methodology simplifies the required calculations by eliminating the potential need to maintain multiple prepayment credit bases. More importantly, it prevents one segment from having an unfunded CAS pension cost for a year in which another segment maintains a prepayment credit.”

The CMS Office of Actuary comments are included in its entirety as Appendix C.

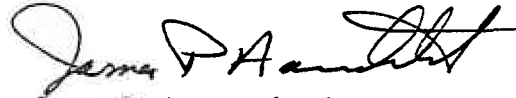
This report reflects all revisions identified above.

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determinations as to actions to be taken on all matters reported will be made by the CMS 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, 5 U.S.C. 552, as amended by Public Law 104-231, OIG, OAS, reports are made available to the public to the extent information contained therein is not subject to exemptions in the Act. (See 45 CFR Part 5.) As such, within 10 business days after the final report is issued, it will be posted on the worldwide web at <http://oig.hhs.gov/>.

Sincerely,



James P. Aasmundstad
Regional Inspector General for
Audit Services, Region VII

Enclosure:

CMS Action Official

Rose Crum-Johnson
Regional Administrator, Region IV
Centers for Medicare & Medicaid Services
Sam Nunn Atlanta Federal Center
4th Floor 61 Forsyth Street, SW Suite 4T20
Atlanta, GA 30303

BLUE CROSS AND BLUE SHIELD OF NORTH CAROLINA

STATEMENT OF ALLOWABLE CAS PENSION COSTS

FOR FISCAL YEARS 1992 THROUGH 2001

Date	Description		Total Company	Other Segments	Medicare Segment
1992	Contributions	<u>1/</u>	\$4,245,810	\$4,103,312	\$142,498
8.00%	Discount for interest	<u>2/</u>	(18,996)	(18,358)	(638)
1/1/92	Pres Val Contributions	<u>3/</u>	4,226,814	4,084,954	141,860
1/1/92	Prepayment Credit	<u>4/</u>	1,854,686	1,686,224	168,462
1/1/92	Pres Value of Funding	<u>5/</u>	6,081,500	5,771,178	310,322
1/1/92	CAS Pension Cost	<u>6/</u>	3,772,914	3,462,592	310,332
1/1/92	CAS Funding Target	<u>7/</u>	3,772,914	3,462,592	310,322
1/1/92	% Funded	<u>8/</u>		100.00%	100.00%
1/1/92	Funded Pension Cost	<u>9/</u>		3,462,592	310,322
	Allowable Interest	<u>10</u>		7,983	638
	Allocable Pension Cost	<u>11/</u>		3,470,575	310,960
	Fiscal Year Pension	<u>12/</u>		2,615,322	307,864
	Medicare LOB %	<u>13/</u>		1.34%	97.16%
	Allowable Pension Cost	<u>14/</u>	\$334,166	\$35,045	\$299,121

1993	Contributions		\$4,700,000	\$4,554,989	\$145,011
8.00%	Discount for interest		(32,273)	(31,277)	(996)
1/1/93	Pres Val Contributions		4,667,727	4,523,712	144,015
1/1/93	Prepayment Credit		2,493,273	2,294,772	198,501
1/1/93	Pres Value of Funding		7,161,000	6,818,484	342,516
1/1/93	CAS Pension Cost		4,302,172	3,959,656	342,516
1/1/93	CAS Funding Target		4,302,172	3,959,656	342,516
1/1/93	% Funded			100.00%	100.00%
1/1/93	Funded Pension Cost			3,959,656	342,516
	Allowable Interest			11,511	996
	Allocable Pension Cost			3,971,167	343,512
	Fiscal Year Pension			3,846,019	335,374
	Medicare LOB %			1.44%	97.77%
	Allowable Pension Cost		\$383,278	\$55,383	\$327,895

BLUE CROSS AND BLUE SHIELD OF NORTH CAROLINA

STATEMENT OF ALLOWABLE CAS PENSION COSTS

FOR FISCAL YEARS 1992 THROUGH 2001

Date	Description	Total Company	Other Segments	Medicare Segment
1994	Contributions	\$3,751,961	\$3,679,630	\$72,331
8.00%	Discount for interest	(8,115)	(7,959)	(156)
1/1/94	Pres Val Contributions	3,743,846	3,671,671	72,175
1/1/94	Prepayment Credit	3,087,534	2,862,979	224,555
1/1/94	Pres Value of Funding	6,831,380	6,534,650	296,730
1/1/94	CAS Pension Cost	4,079,900	3,783,170	296,730
1/1/94	CAS Funding Target	4,079,900	3,783,170	296,730
1/1/94	% Funded		100.00%	100.00%
1/1/94	Funded Pension Cost		3,783,170	296,730
	Allowable Interest		1,995	156
	Allocable Pension Costs		3,785,165	296,886
	Fiscal Year Pension		3,831,665	308,542
	Medicare LOB %		1.26%	97.88%
	Allowable Pension Cost	\$350,280	\$48,279	\$302,001

1995	Contributions	\$5,085,500	\$4,958,278	\$127,222
8.00%	Discount for interest	(34,657)	(33,790)	(867)
1/1/95	Pres Val Contributions	5,050,843	4,924,488	126,355
1/1/95	Prepayment Credit	2,971,598	2,752,151	219,447
1/1/95	Pres Value of Funding	8,022,441	7,676,639	345,802
1/1/95	CAS Pension Cost	4,682,603	4,336,801	345,802
1/1/95	CAS Funding Target	4,682,603	4,336,801	345,802
1/1/95	% Funded		100.00%	100.00%
1/1/95	Funded Pension Cost		4,336,801	345,802
	Allowable Interest		10,873	867
	Allocable Pension Cost		4,347,674	346,669
	Fiscal Year Pension		4,207,047	334,223
	Medicare LOB %		1.14%	100.00%
	Allowable Pension Cost	\$382,183	\$47,960	\$334,223

BLUE CROSS AND BLUE SHIELD OF NORTH CAROLINA

STATEMENT OF ALLOWABLE CAS PENSION COSTS

FOR FISCAL YEARS 1992 THROUGH 2001

Date	Description	Total Company	Other Segments	Medicare Segment
1996	Contributions	\$5,556,067	\$5,387,531	\$168,536
8.00%	Discount for interest	(110,710)	(107,352)	(3,358)
1/1/96	Pres Val Contributions	5,445,357	5,280,179	165,178
1/1/96	Prepayment Credit	3,607,026	3,327,720	279,306
1/1/96	Pres Value of Funding	9,052,383	8,607,899	444,484
1/1/96	CAS Pension Cost	5,740,171	5,295,687	444,484
1/1/96	CAS Funding Target	5,740,171	5,295,687	444,484
1/1/96	% Funded		100.00%	100.00%
1/1/96	Funded Pension Cost		5,295,687	444,484
	Allowable Interest		40,011	3,358
	Allocable Pension Cost		5,335,698	447,842
	Fiscal Year Pension		5,088,692	422,549
	Medicare LOB %		1.32%	100.00%
	Allowable Pension Cost	\$489,720	\$67,171	\$422,549

1997	Contributions	\$5,500,000	\$5,333,026	\$166,974
8.00%	Discount for interest	(92,441)	(89,635)	(2,806)
1/1/97	Pres Val Contributions	5,407,559	5,243,391	164,168
1/1/97	Prepayment Credit	3,577,189	3,303,648	273,541
1/1/97	Pres Value of Funding	8,984,478	8,547,039	437,709
1/1/97	CAS Pension Cost	5,724,061	5,286,352	437,709
1/1/97	CAS Funding Target	5,724,061	5,286,352	437,709
1/1/97	% Funded		100.00%	100.00%
1/1/97	Funded Pension Cost		5,286,352	437,709
	Allowable Interest		33,894	2,806
	Allocable Pension Cost		5,320,246	440,515
	Fiscal Year Pension		5,324,109	442,347
	Medicare LOB %		1.23%	98.87%
	Allowable Pension Cost	\$502,835	\$65,487	\$437,348

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STATEMENT OF ALLOWABLE CAS PENSION COSTS

FOR FISCAL YEARS 1992 THROUGH 2001

Date	Description	Total Company	Other Segments	Medicare Segment
1998	Contributions	\$5,200,000	\$5,038,977	\$161,023
8.00%	Discount for interest	(51,769)	(50,166)	(1,603)
1/1/98	Pres Val Contributions	5,148,231	4,988,811	159,420
1/1/98	Prepayment Credit	3,521,542	3,254,743	266,799
1/1/98	Pres Value of Funding	8,669,773	8,243,554	426,219
1/1/98	CAS Pension Cost	5,625,760	5,199,542	426,218
1/1/98	CAS Funding Target	5,625,760	5,199,542	426,218
1/1/98	% Funded		100.00%	100.00%
1/1/98	Funded Pension Cost		5,199,542	426,218
	Allowable Interest		19,556	1,603
	Allocable Pension Costs		5,219,098	427,821
	Fiscal Year Pension		5,244,385	430,994
	Medicare LOB %		0.82%	97.65%
	Allowable Pension Cost	\$463,870	\$43,004	\$420,866

1999	Contributions	\$7,000,000	\$6,720,304	\$279,696
8.00%	Discount for interest	(225,452)	(216,444)	(9,008)
1/1/99	Pres Val Contributions	6,774,548	6,503,860	270,688
1/1/99	Prepayment Credit	3,287,535	3,054,140	233,395
1/1/99	Pres Value of Funding	10,062,083	9,558,000	504,083
1/1/99	CAS Pension Cost	7,100,383	6,596,300	504,083
1/1/99	CAS Funding Target	7,100,383	6,596,300	504,083
1/1/99	% Funded		100.00%	100.00%
1/1/99	Funded Pension Cost		6,596,300	504,083
	Allowable Interest		117,881	9,008
	Allocable Pension Cost		6,714,181	513,091
	Fiscal Year Pension		6,340,410	491,773
	Medicare LOB %		1.69%	100.00%
	Allowable Pension Cost	\$598,927	\$107,153	\$491,774

BLUE CROSS AND BLUE SHIELD OF NORTH CAROLINA

STATEMENT OF ALLOWABLE CAS PENSION COSTS

FOR FISCAL YEARS 1992 THROUGH 2001

Date	Description	Total Company	Other Segments	Medicare Segment
2000	Contributions	\$0	\$0	\$0
8.00%	Discount for interest	0	0	0
1/1/00	Pres Val Contributions	0	0	0
1/1/00	Prepayment Credit	0	0	0
1/1/00	Pres Value of Funding	0	0	0
1/1/00	CAS Pension Cost	0	0	0
1/1/00	CAS Funding Target	0	0	0
1/1/00	% Funded		0.00%	0.00%
1/1/00	Funded Pension Cost		0	0
	Allowable Interest		0	0
	Allocable Pension Cost		0	0
	Fiscal Year Pension		1,678,545	128,273
	Medicare LOB %		1.98%	100.00%
	Allowable Pension Cost	\$161,508	\$33,235	\$128,273
2001	Contributions	\$0	\$0	\$0
8.00%	Discount for interest	0	0	0
1/1/01	Pres Val Contributions	0	0	0
1/1/01	Prepayment Credit	0	0	0
1/1/01	Pres Value of Funding	0	0	0
1/1/01	CAS Pension Cost	0	0	0
1/1/01	CAS Funding Target	0	0	0
1/1/01	% Funded		0.00%	0.00%
1/1/01	Funded Pension Cost		0	0
	Allowable Interest		0	0
	Allocable Pension Cost		0	0
	Fiscal Year Pension		0	0
	Medicare LOB %		1.50%	100.00%
	Allowable Pension Cost	\$0	\$0	\$0

BLUE CROSS AND BLUE SHIELD OF NORTH CAROLINA

STATEMENT OF ALLOWABLE CAS PENSION COSTS

FOR FISCAL YEARS 1992 THROUGH 2001

Date	Description	Total Company	Other Segments	Medicare Segment
2002	Contributions	\$0	\$0	\$0
8.00%	Discount for interest	0	0	0
1/1/02	Pres Val Contributions	0	0	0
1/1/02	Prepayment Credit	0	0	0
1/1/02	Pres Value of Funding	0	0	0
1/1/02	CAS Pension Cost	0	0	0
1/1/02	CAS Funding Target	0	0	0
1/1/02	% Funded		0.00%	0.00%
1/1/02	Funded Pension Cost		0	0
	Allowable Interest		0	0
	Allocable Pension Cost		0	0
	Fiscal Year Pension		0	0
	Medicare LOB %		1.50%	100.00%
	Allowable Pension Cost	\$0	\$0	\$0

FOOTNOTES

- 1/ We obtained total company contribution amounts and dates of deposit from the IRS Form 5500 Reports. The contributions included deposits made during the plan year and accrued contributions deposited after the end of the plan year but within the time allowed for filing tax returns.
- 2/ We subtracted interest that is included in the contributions deposited after January 1 of each year to discount the contributions back to their beginning of the year value. For the purposes of this appendix, we computed interest as the difference between the present value of contributions, at the valuation interest rate, and the actual contribution amounts.
- 3/ The present value of contributions is the value of the contributions discounted from the date of deposit back to January 1. For purposes of this appendix, we deemed deposits made after the end of the plan year to have been made on the final day of the plan year.

BLUE CROSS AND BLUE SHIELD OF NORTH CAROLINA

STATEMENT OF ALLOWABLE CAS PENSION COSTS

FOR FISCAL YEARS 1992 THROUGH 2001

- 4/ A prepayment credit represents the premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year CAS funding target. A prepayment credit may be carried forward, with interest, to fund future CAS pension costs.
- 5/ The present value of funding represents the present value of contributions plus prepayment credits. This is the amount of funding that is available to cover the CAS funding target measured at January 1 of each year.
- 6/ The CAS pension costs, computed at January 1 of each year, provides the basis to compute the allowable pension cost that can be charged to Medicare.
- 7/ 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).
- 8/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Since any funding in excess of the CAS funding target is considered premature funding in accordance with CAS 412.50(a)(7), we determined that 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.
- 9/ We computed the funded CAS pension costs as the CAS funding target multiplied by the percent funded.
- 10/ We assumed interest on the funded CAS pension cost is to accrue in the same proportion as the interest on contributions bears to the present value of funding. However, we limited interest by FAR 31.205-6(j)(3)(iii) which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target were funded in four equal installments deposited within 30 days of the end of the quarter.
- 11/ The allocable CAS pension cost is the amount of pension cost, which may be allocated for contract cost purposes.

BLUE CROSS AND BLUE SHIELD OF NORTH CAROLINA

STATEMENT OF ALLOWABLE CAS PENSION COSTS

FOR FISCAL YEARS 1992 THROUGH 2001

- 12/ We converted the plan year allowable CAS pension costs to a fiscal year basis (October 1 through September 30). We calculated the fiscal year pension costs as one-fourth (1/4) of the prior year's costs plus three-fourths (3/4) of the current year's costs. Cost charged to the Medicare contract should consist of the Medicare segment's direct pension costs plus pension costs attributable to indirect Medicare operations.
- 13/ We calculated allowable pension costs of the Medicare and other segments based on the Medicare line of business (LOB) percentage of each segment. We obtained the percentages from documents provided by North Carolina.
- 14/ We computed the allowable Medicare pension costs as the Fiscal Year pension cost multiplied by the Medicare LOB percentage.

Via Facsimile
(573-893-5416)

James P Aasmundstad
Regional Inspector General
Office of Inspector General
Office of Audit Services
Region VII
601 East 12th Street
Room 284A
Kansas City, MO 64106

Re: Office of Inspector General (OIG), Office of Audit Services (OAS) Draft Report on Blue Cross and Blue Shield of North Carolina Pension Costs Claimed For Medicare Reimbursement, December 2002 (CIN: A-07-02-03030)

Dear Mr. Aasmundstad:

Blue Cross and Blue Shield of North Carolina ("BCBSNC") hereby submits its comments on the above referenced draft report. While BCBSNC generally agrees with the conclusion that it did not claim all allowable pension costs for FY 1992 through 2001, we are not in a position, at this time, to definitively agree with the specific calculations or methodologies utilized by the auditors.

We submit the following for your consideration at this time. We will alert you and/or CMS to the extent we identify any additional, significant issues in the future.

- **Determination of Fiscal Year 2001 and Fiscal Year 2002 Expense**

It is not clear that the auditors correctly calculated the actuarial value of assets for January 1, 2001. In the auditors' workpapers, a \$0 value was assigned for the cost basis resulting in the actuarial value of assets being set to 80% of the market value of assets. It appears this caused the auditors to value actuarial value of assets for the total company at \$162,325,142 when the value should be \$198,786,755. Had the auditors had used the correct value, the assignable cost limitation under CAS 412-50(c)(ii) would have been \$0 for calendar year 2001 and the allowable pension cost for fiscal 2001 and fiscal 2002 would have been \$0.

- **Allowable Administrative Costs Allocable to Medicare Activities**

The draft audit report may have failed to quantify BCBSNC's allowable administrative costs. A past Office of Inspector General (OIG), Office of Audit Services (OAS) report, issued in April 1994 and

entitled "Review of Pension Costs Claimed for Medicare Reimbursement by BCBSNC" (CIN A-07-93-00685), did quantify such costs.

- **Treatment of Investment Expenses**

In determining the investment return of the asset fund in 1993, 1994, and 1996 the auditors assumed that investment expenses were paid at the end of the year. We believe that the investment expenses would have occurred evenly throughout the year and they should have received a mid-year weighting.

- **Inconsistencies with Prior Audit**

The method used to develop prepayment credits in the draft report appears to be inconsistent with the method used in the April 1994 OIG OAS report entitled "Review of Pension Costs Claimed for Medicare Reimbursement by BCBSNC" (CIN A-07-93-00685). For example, under the prior audit, contributions were allocated to the Medicare segment based on the ratio of the CAS pension cost for the Medicare segment to the CAS pension cost for the total company. Prepayment credits were then determined directly for the Medicare segment based on the allocated contribution and the CAS pension cost for the Medicare segment. For the current audit, the prepayment credit is not being directly calculated for the Medicare segment. Instead the total company's prepayment credit is being allocated to the Medicare segment based on the next year's CAS pension cost. The contribution then allocated to the Medicare segment equals the allocated prepayment credit and the CAS pension cost for the year.

Please let us know if you would like to discuss these comments prior to the issuance of a final report.

Sincerely,



W. Bruce Shirk

WBS:bct

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cc: Christopher C. Woodfin

Jennifer Yanulavich



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MEMORANDUM

To: Greg Tambke, Audit Manager
HHS/OIG/OAS, Jefferson City, Missouri

From: Veda D. Wild

Date: February 4, 2003

Subject: Response to the Draft OIG Audit Report CIN A-07-02-03030, *Blue Cross and Blue Shield of North Carolina Pension Costs Claimed For Medicare Reimbursement*

In a letter dated January 27, 2003, Blue Cross and Blue Shield of North Carolina (BCBSNC), responding through W. Bruce Shirk of Powell, Goldstein, Frazer and Murphy, LLP, questioned specific calculations or methodologies used by the auditors. This memorandum addresses two of the issues raised in that letter.

1. Treatment of Investment Expenses

BCBCNC Comment: In determining the investment return of the asset fund in 1993, 1994, and 1996 the auditors assumed that investment expenses were paid at the end of the year. We believe that the investment expenses would have occurred evenly throughout the year and they should have received a mid-year weighting.

Response: CAS 413-50(c)(7), as in effect prior to March 30, 1995, provided for fund income and expenses to be allocated in proportion to fund assets as of the beginning of the period. CAS 413-50(c)(7), as amended effective March 30, 1995, required fund income and expenses to be allocated in proportion to the average value of pension assets for the period. The asset rollup prepared by BCBSNC's actuary was based on an allocation in proportion to the weighted average asset value for all periods under review, including years governed by the pre-amended version of CAS 413. Nevertheless, because the weighted average methodology is more accurate than a beginning of year allocation, BCBSNC's methodology was accepted for all years. Furthermore, the asset calculations used by the auditors reflect a mid-year weighting of expenses.

In the audit worksheet formula that determines the investment return to be credited to the Medicare segment, the denominator of the fraction represents the weighted average asset value. Since the denominator contains no adjustment for expenses, BCBSNC may have concluded that expenses are treated as occurring at the end of the year. However, expenses are treated as a negative investment return and are allocated in the same manner as investment return. Both investment return and expenses are allocated using the weighted asset value. This methodology effectively treats both investment return and expenses as if they occurred evenly throughout the year (mid-year weighting).

It is not clear why BCBSNC is limiting its remarks to 1993, 1994 and 1996. For 1994 and all years after 1996, the investment return shown in the asset rollup was net of expenses there were no expenses separately identified. For years prior to 1994 and for 1995, expenses were separately identified. However, this was simply a difference in the manner of presentation and had no effect on the allocation of investment return or the resulting asset values. The methodology described above was applied consistently to all years in the audit period.

2. Inconsistencies with Prior Audit

BCBSNC Comment: The method used to develop prepayment credits in the draft report appears to be inconsistent with the method used in the April 1994 OIG OAS report entitled "Review of Pension Costs Claimed for Medicare Reimbursement by BCBSNC" (CIN A-07-93-00685). For example, under the prior audit, contributions were allocated to the Medicare segment based on the ratio of the CAS pension cost for the Medicare segment to the CAS pension cost for the total company. Prepayment credits were then determined directly for the Medicare segment based on the allocated contribution and the CAS pension cost for the Medicare segment. For the current audit, the prepayment credit is not being directly calculated for the Medicare segment. Instead the total company's prepayment credit is being allocated to the Medicare segment based on the next year's CAS pension cost. The contribution then allocated to the Medicare segment equals the allocated prepayment credit and the CAS pension cost for the year.

Response: The change in methodology for prepayment credits between the draft report and the prior audit was intentional. In the draft report, prepayment credits are not allocated to the Medicare segment until needed to cover a subsequent year's pension cost. Since prepayment credits are subtracted from both the Medicare segment assets and "other" segment assets for cost calculation purposes, the two methods will produce very similar results. However, the revised methodology simplifies the required calculations by eliminating the potential need to maintain multiple prepayment credit bases. More importantly, it prevents one segment from having an unfunded CAS pension cost for a year in which another segment maintains a prepayment credit.

Please feel free to contact me at 410-786-6626 or Eric Shipley at 410-786-6381 if you have any questions.

ACKNOWLEDGMENTS

This report was prepared under the direction of James P. Aasmundstad, Regional Inspector General for Audit Services. Other principal Office of Audit Services staff that contributed include:

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For information or copies of this report, please contact the Office of Inspector General's Public Affairs office at (202) 619-1343.