

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE  
CONTRACTOR'S PENSION  
SEGMENTATION, BLUE CROSS  
AND BLUE SHIELD OF NEW MEXICO**



**JUNE GIBBS BROWN**  
**Inspector General**

**FEBRUARY 1997**  
**CIN: A-07-96-01195**



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-07-96-01195

FEB 4 1997

Ms. Pat Miller  
Manager of Cost Accounting  
Rocky Mountain Health Care Corporation  
700 East Broadway  
Denver, Colorado 80273

Dear Ms. Miller:

This report provides you with the results of the Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Medicare Contractor's Pension Segmentation, Blue Cross and Blue Shield of New Mexico*. The purpose of our review was to evaluate Blue Cross and Blue Shield of New Mexico's (New Mexico) compliance with the pension segmentation requirements of its Medicare contract.

We identified Medicare segment assets of \$508,856 as of 1986. Additionally, we updated Medicare segment assets from Plan Year 1986 to Plan Year 1988 and identified segment assets of \$616,574 as of January 1, 1988.

New Mexico merged with Blue Cross and Blue Shield of Colorado and Blue Cross and Blue Shield of Nevada in 1989, and the corporate name was changed to Rocky Mountain Health Care Corporation. The three companies' pension plans were officially merged on January 1, 1989. However, New Mexico's pension assets were not separately accounted for after Plan Year 1987. Instead, the Medicare segment pension assets of New Mexico were included in Rocky Mountain's update of pension assets for Plan Year 1988. We separately accounted for New Mexico's assets (\$700,952) to January 1, 1989. We recommend that New Mexico separately identify Medicare segment assets to January 1, 1989. The Auditee was unable to provide a definitive response to our report within the 75 days granted to them for providing a response (30 initial days plus a 45 day extension). The auditee's letter is included as Appendix B.

## INTRODUCTION

New Mexico administered Medicare Part A under cost reimbursement contracts since 1966. In claiming costs, contractors were to follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), the Cost Accounting Standards (CAS), and the Medicare contracts.

Since its inception, Medicare paid a portion of the annual contributions made by contractors to their pension plans. 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.

New Mexico'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 agreement/contract; or*
- 2. Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract.*

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 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.

To ensure contractors developed and maintained the data necessary for segmentation calculations, HCFA distributed a pension cost questionnaire to contractors in 1989. New Mexico's questionnaire response of June 7, 1989 identified total pension assets of \$4,761,892 and Medicare segment assets of \$508,856 as of January 1, 1986. New Mexico also concluded that separate valuations for the Medicare segment were required.

New Mexico participates in the National Retirement Program administered by the Blue Cross/Blue Shield National Employee Benefits Administration (NEBA). The Watson Wyatt Worldwide, NEBA's actuarial firm, played a major role in the preparation of New Mexico's questionnaire response.

## **OBJECTIVE, SCOPE AND METHODOLOGY**

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine New Mexico's compliance with pension segmentation requirements of its Medicare contract. Achieving the objective did not require a review of New Mexico's internal control structure. The audit addressed New Mexico's initial determination of pension assets for its Medicare segment and later updates. Our review covered January 1, 1981 to January 1, 1989.

This review was performed in conjunction with our audit of pension costs claimed for Medicare reimbursement (CIN: A-07-96-01196). The information obtained and reviewed during that audit was also used in performing this review.

We reviewed New Mexico's identification of the Medicare segment as of January 1, 1988 and traced the organizational lineage back to 1981. We also reviewed New Mexico's computation of the asset fraction and its update of Medicare assets from January 1, 1986 to January 1, 1989.

In performing the review, we used information provided by NEBA and NEBA's pension actuary. The information included liabilities, normal costs, contributions, earnings, and expenses. We reviewed New Mexico's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, we calculated Medicare segment assets as of January 1, 1989. The HCFA pension actuarial staff reviewed our methodology and calculations.

Site work at Rocky Mountain's corporate offices in Denver, Colorado was performed during June 1996. We performed subsequent audit work in our OIG, OAS Jefferson City, Missouri field office.

## **FINDING AND RECOMMENDATION**

### **MEDICARE ASSETS AS OF JANUARY 1, 1986**

New Mexico calculated an asset fraction of 10.6860 percent as of January 1, 1981. We determined that New Mexico correctly identified the organizational components and participants of the Medicare segment as of 1981. Accordingly, New Mexico correctly calculated the 1981 asset fraction, which when applied to the total company assets as of January 1, 1986 correctly established the Medicare segment's asset base of \$508,856.

### **MEDICARE ASSET BASE AS OF JANUARY 1, 1986 UPDATED TO JANUARY 1, 1988**

New Mexico's methodology in updating the Medicare segment assets from January 1, 1986 to January 1, 1988 understated the segment assets by \$100,947. This understatement primarily occurred because New Mexico misidentified plan participants.

#### **Updating Segment Assets**

As of January 1, 1988, New Mexico determined Medicare segment assets of \$515,627. We identified Medicare segment pension assets of \$616,574 as of January 1, 1988. The increase of \$100,947 resulted from: (1) assigning pension contributions equitably to the Medicare segment (\$2,682 decrease), (2) adjusting benefit payments (\$9,401 decrease), (3) adjusting for participants that moved in and out of the Medicare segment (\$109,093 increase), and (4) calculating the update with corrected asset amounts (\$3,937 increase).

#### **Pension Contributions**

New Mexico's update methodology assigned contributions to the Medicare segment based on the ratio of segment participants' normal costs and accrued liability to total company normal costs and accrued liability. Because, New Mexico's update incorrectly identified plan participants in the Medicare segment, it overstated the segment's assigned contributions by \$2,682 for 1987. We correctly identified the plan participants in 1987 and assigned the contribution using New Mexico's methodology.

### Benefit Payments

New Mexico omitted benefit payments to two Medicare segment retirees. We identified the benefits paid and used these payments in updating the Medicare segment assets shown in Appendix A. This resulted in a net decrease of \$9,401 in the Medicare segment assets.

### Participant Transfers

New Mexico correctly identified the Medicare segment organizational components and cost centers. However, New Mexico's updates incorrectly identified plan participants in the organizational components and cost centers. Some individuals were considered nonsegment participants and should have been considered segment participants. Some individuals were considered segment participants and should have been considered nonsegment participants.

Since the identification of the segment participants was incorrect, transfers (representing the movement into and out of the segment each year) in the updates were also incorrect. The following table compares New Mexico's and our computations of transfer amounts:

#### Transfer Adjustments to the Medicare Segment

<u>Year</u>	<u>New Mexico</u>	<u>OIG</u>
1986	\$(111,281)	\$3,682
1987	(24,583)	(30,453)
Total	<u>\$(135,864)</u>	<u>\$(26,771)</u>

We corrected the identification of the segment participants and transfer amounts in updating the Medicare segment assets. See Appendix A. Our computation resulted in a net increase of \$109,093 (\$135,864 less \$26,771) in the Medicare segment assets.

### Earnings and Expenses

New Mexico's update methodology allocated investment earnings and expenses to the Medicare segment based on a ratio of segment assets to total company assets. Because New Mexico's asset amounts were incorrect, it understated the segment's earnings and expenses for each year of the update. We used New Mexico's allocation methodology in our update and increased Medicare segment assets by \$3,937.

**Recommendation:**

We recommend that New Mexico:

- ❶ Increase the Medicare segment pension assets by \$100,947 as of January 1, 1988.

**Auditee Response**

The Auditee stated they were unable to provide a definitive response to our report within the 75 days granted to them for providing a response (30 initial days plus a 45 day extension). They also stated they would continue their evaluation of the draft audit report and will work with us and the Contracting Officer to bring these matters to a prompt and fair resolution.

**MEDICARE'S ASSET BASE AS OF JANUARY 1, 1988  
UPDATED TO JANUARY 1, 1989**

New Mexico's and Rocky Mountain's pension plans were officially merged as of January 1, 1989. However, for accounting purposes, NEBA merged the pension assets as of January 1, 1988. As a result, New Mexico's update of pension assets after Plan Year 1987 was not calculated. Our update separately accounted for New Mexico's pension assets to January 1, 1989. We determined that New Mexico's Medicare segment pension assets were \$700,952 as of January 1, 1989. See Appendix A.

**Recommendation:**

We recommend that New Mexico:

- ❷ Separately account for Medicare segment pension assets to January 1, 1989.
- ❸ Identify Medicare segment pension assets of \$700,952 as of January 1, 1989.

**Auditee Response**

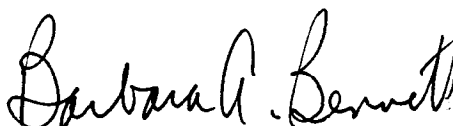
The Auditee stated they were unable to provide a definitive response to our report within the 75 days granted to them for providing a response (30 initial days plus a 45 day extension). They also stated they would continue their evaluation of the draft audit report and will work with us and the Contracting Officer to bring these matters to a prompt and fair resolution.

**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 on the following page. We request that you respond to the recommendation in this report within 30 days from the date of this report to the HHS 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 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 large initial 'B'.

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

HHS Action Official:

Ms. Mary K. Smith  
Regional Administrator, Region VIII  
Health Care Financing Administration  
1961 Stout Street  
Denver, Colorado 80294-3538

Enclosures



## BLUE CROSS AND BLUE SHIELD OF NEW MEXICO

CIN: A-07-96-01195

STATEMENT OF MEDICARE PENSION ASSETS  
JANUARY 1, 1986 TO JANUARY 1, 1989

Description		Total Company	Other Segment	Medicare
<b>Assets January 1, 1986</b>	<u>1/</u>	<b>\$4,761,892</b>	<b>\$4,253,036</b>	<b>\$508,856</b>
Contributions		0	0	0
Prepayment		0	0	0
Earnings	<u>2/</u>	748,166	668,217	79,949
Benefits	<u>3/</u>	(140,842)	(131,441)	(9,401)
Expenses	<u>4/</u>	(30,864)	(27,566)	(3,298)
Transfers	<u>5/</u>	0	(3,682)	3,682
<b>Assets January 1, 1987</b>		<b>\$5,338,352</b>	<b>\$4,758,564</b>	<b>\$579,788</b>
Contributions	<u>6/</u>	463,211	420,488	42,723
Prepayment		0	0	0
Earnings		262,359	233,865	28,494
Benefits		(296,281)	(296,281)	0
Expenses		(36,624)	(32,646)	(3,978)
Transfers		0	30,453	(30,453)
<b>Assets January 1, 1988</b>		<b>\$5,731,017</b>	<b>\$5,114,443</b>	<b>\$616,574</b>
Contributions		0	0	0
Prepayment	<u>7/</u>	0	(4,137)	4,137
Earnings		785,363	700,869	84,494
Benefits		(163,919)	(163,919)	0
Expenses		(39,534)	(35,281)	(4,253)
<b>Assets January 1, 1989</b>		<b>\$6,312,927</b>	<b>\$5,611,975</b>	<b>\$700,952</b>

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STATEMENT OF MEDICARE PENSION ASSETS  
JANUARY 1, 1986 TO JANUARY 1, 1989

## DETERMINATION OF ASSET VARIANCE AS OF JANUARY 1, 1988

Description	Total Company	Other Segment	Medicare
Assets January 1, 1988	\$5,731,017	\$5,114,443	\$616,574
Assets per New Mexico <u>8/</u>	\$5,731,017	\$5,215,390	\$515,627
Variance <u>9/</u>	\$0	\$(100,947)	\$100,947

## FOOTNOTES

- 1/ We reviewed New Mexico's asset fraction calculation and determined that New Mexico had correctly computed the 1981 asset fraction (10.6860%).
- 2/ New Mexico provided earning 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 beginning of year market value of total assets. New Mexico used this same methodology.
- 3/ New Mexico provided benefit payment amounts and we verified them to IRS Form 5500 reports. We used actual benefit payments for Medicare segment retirees.
- 4/ New Mexico 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 beginning of year market value of total assets. New Mexico used this same methodology.
- 5/ We identified participant transfers between segments by comparing annual participant

BLUE CROSS AND BLUE SHIELD OF NEW MEXICO

CIN: A-07-96-01195

STATEMENT OF MEDICARE PENSION ASSETS  
JANUARY 1, 1986 TO JANUARY 1, 1989

valuation listings provided by New Mexico. 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.

- 6/ We obtained total contribution amounts from IRS Form 5500 reports. We allocated the 1987 contribution to the Medicare segment based on the ratio of segment participants' normal costs and accrued liability to total company normal costs and accrued liability. New Mexico used this same methodology. New Mexico did not make contributions to the pension trust fund for years 1986 and 1988.
- 7/ New Mexico's 1987 contribution to the pension trust fund exceeded the CAS pension costs, thereby creating a prepayment credit. The prepayment remains unassigned and accumulates interest in the pension trust fund until needed to fund future CAS pension costs. We assigned the prepayment in proportion to the CAS pension costs.
- 8/ We obtained the total assets as of January 1, 1988 from New Mexico's update of assets provided by its actuary.
- 9/ The asset variance represents the difference between the OIG calculation of assets as of January 1, 1988 and the assets calculated by New Mexico's actuary.



January 27, 1997

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

Dear Ms. Bennett:

Thank you for extending until January 27, 1997, the time for our response to the following draft audit reports:

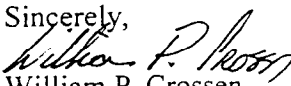
CIN: A-07-96-01198 CIN: A-07-96-01199  
CIN: A-07-96-01185 CIN: A-07-96-01195  
CIN: A-07-96-01196 CIN: A-07-96-01197

Those draft audit reports relate to the Office of Inspector General's audit of Blue Cross and Blue Shield of Colorado's and Blue Cross and Blue Shield of New Mexico's claimed pension costs, pension segmentation, and unfunded pension costs for Fiscal Years 1988 through 1995.

As you know, the proper treatment of pension costs pursuant to CAS 412 and 413 may be the single most difficult government cost accounting issue, and there are complex interactions among the draft reports. Despite our best efforts, and those of our outside actuarial, legal and accounting consultants, we have not yet been able to complete our review and analysis of the issues raised in the draft reports. Accordingly, we are unable to provide you at this time with the definitive Plan responses that you have requested.

We understand from your letter of December 17, 1996, that you will not grant us a further extension at this time. Nonetheless, please be assured that we will continue our evaluation of the draft audit reports, and will work with your auditors and the Contracting Officer to bring these matters, and the related contract termination pension cost matters, to a prompt and fair resolution.

Thank you for affording us an opportunity to comment on the draft audit reports. We regret that we are unable to do so at this time.

Sincerely,  
  
William P. Crossen  
Chief Financial Officer