



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

APR 06 2009

Report Number: A-07-09-00306

Region VII
601 East 12th Street
Room 0429
Kansas City, Missouri 64106

Ms. Karen Abraham
Senior Vice President, Finance and Administration
Blue Cross Blue Shield of Arizona
P.O. Box 13446
8220 North 23rd Avenue
Phoenix, Arizona 85021

Dear Ms. Abraham:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of the Pension Segmentation Requirements for the Qualified Pension Plan at Blue Cross Blue Shield of Arizona, a Terminated Medicare Contractor, for the Period January 1, 2005, to September 30, 2006." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this 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.

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If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through e-mail at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-09-00306 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Mr. Timothy Hill, Director & Chief Financial Officer
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Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF THE PENSION
SEGMENTATION REQUIREMENTS
FOR THE QUALIFIED PENSION PLAN
AT BLUE CROSS BLUE SHIELD OF
ARIZONA, A TERMINATED
MEDICARE CONTRACTOR, FOR THE
PERIOD JANUARY 1, 2005, TO
SEPTEMBER 30, 2006**



Daniel R. Levinson
Inspector General

April 2009
A-07-09-00306

Office of Inspector General

<http://oig.hhs.gov>

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

The designation of financial or management practices as questionable, a recommendation for the disallowance of costs incurred or claimed, and any other conclusions and recommendations in this report represent the findings and opinions of OAS. Authorized officials of the HHS operating divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

Blue Cross Blue Shield of Arizona (Arizona) administered Medicare Part A operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS) until its contractual relationship was terminated on September 30, 2006. The effective closing date for the Medicare segment was September 30, 2006.

Starting with fiscal year 1988, CMS incorporated segmentation requirements into Medicare contracts. The Medicare contracts define a segment and specify the methodology for the identification and initial allocation of pension assets to the segment. Furthermore, the contracts require Medicare segment pension assets to be updated for each year after the initial allocation in accordance with Cost Accounting Standards (CAS) 412 and 413. Additionally, in situations such as contract terminations, the Medicare contracts require contractors to make segment closing adjustments in order to recognize Medicare's share of the excess Medicare segment pension assets and/or liabilities in accordance with CAS 413.

OBJECTIVE

Our objective was to determine whether Arizona complied with Federal requirements and the Medicare contracts' pension segmentation requirements when:

- implementing the prior audit recommendation,
- updating the Medicare segment's pension assets from January 1, 2005, to September 30, 2006, and
- determining Medicare's share of excess liabilities as a result of the termination of the Medicare contracts.

SUMMARY OF FINDINGS

Arizona properly implemented the prior audit recommendation; however, Arizona did not use the correct total company investment earnings and administrative expenses when allocating the administrative expenses to the Medicare segment during the period of January 1, 2006, to September 30, 2006. Arizona identified Medicare segment pension assets of \$2,180,138; however, we determined the Medicare segment pension assets were \$2,178,510 as of September 30, 2006. As a result, Arizona overstated the Medicare segment pension assets by \$1,628.

In addition, the CAS requires a segment closing adjustment to be made in order to recognize Medicare's share of the excess liabilities as a result of the termination of the Medicare contracts. Arizona did not calculate Medicare's share of the excess pension liabilities; however, we calculated Medicare's share of the excess pension liabilities to be \$244,359 as of September 30, 2006.

RECOMMENDATIONS

We recommend that Arizona:

- decrease the Medicare segment pension assets by \$1,628 as of September 30, 2006, and
- recognize \$244,359 as Medicare's share of the Medicare segment excess pension liabilities due to the segment closing calculation.

AUDITEE COMMENTS

In written comments on our draft report, Arizona agreed with our recommendations. Arizona's comments are included in their entirety as Appendix C.

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Glossary of Abbreviations and Acronyms

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

INTRODUCTION

BACKGROUND

Blue Cross Blue Shield of Arizona

Blue Cross Blue Shield of Arizona (Arizona) administered Medicare Part A operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS) until its contractual relationship was terminated on September 30, 2006. The effective closing date for the Medicare segment was September 30, 2006.

Pension Segmentation

CMS incorporated CAS 412 and 413 into the Medicare contracts effective October 1, 1980. Starting in fiscal year 1988, CMS incorporated segmentation requirements into Medicare contracts. The Medicare contracts define a segment and specify the methodology for the identification and initial allocation of pension assets to the segment. The contracts require Medicare segment assets to be updated for each year after the initial allocation in accordance with Cost Accounting Standards (CAS) 412 and 413. Additionally, in situations such as contract terminations, the Medicare contracts require contractors to make segment closing adjustments in order to recognize Medicare's share of the excess Medicare assets and/or liabilities in accordance with CAS 413. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), CAS, and the Medicare contracts.

Federal Requirements

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

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.

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

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether Arizona complied with Federal requirements and the Medicare contracts' pension segmentation requirements when:

- implementing the prior audit recommendation,

- updating the Medicare segment's pension assets from January 1, 2005, to September 30, 2006, and
- determining Medicare's share of excess liabilities as a result of the termination of the Medicare contracts.

Scope

We reviewed Arizona's identification of its Medicare segment, update of Medicare segment assets from January 1, 2005, to September 30, 2006, and the segment closing calculation as of September 30, 2006. Arizona's Medicare contracts were terminated on September 30, 2006. We used September 30, 2006, the contract termination date, as the settlement date for the contract termination adjustment.

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

We performed fieldwork at our field office, located in Jefferson City, Missouri, from June 2008 through August 2008.

Methodology

To accomplish our objective, we did the following:

- We reviewed the applicable portions of the FAR, CAS, and the Medicare contracts.
- We reviewed the information provided by Arizona's actuarial consulting firm, which included the pension plan's assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We used this information to calculate the Medicare segment pension assets.
- We obtained and reviewed the pension plan documents, actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s used in calculating the Medicare segment pension assets.
- We interviewed Arizona staff responsible for identifying the Medicare segment to determine whether the segment was properly identified in accordance with the Medicare contracts.
- We reviewed Arizona's accounting records to verify the segment identification and benefit payments made to the Medicare segment.
- We reviewed the prior segmentation audit performed at Arizona (A-07-06-00207) to determine the beginning value of assets.

- We provided the CMS Office of the Actuary with the actuarial information necessary to calculate the Medicare segment pension assets from January 1, 2005, to September 30, 2006, and the Medicare segment excess liabilities as of September 30, 2006.
- We reviewed the CMS actuaries' methodology and calculations.

We performed this review in conjunction with our audit of Arizona's pension costs claimed for Medicare reimbursement (A-07-09-00307) and used the information obtained during that audit in this review.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

FINDINGS AND RECOMMENDATIONS

Arizona properly implemented the prior audit recommendation; however, Arizona did not use the correct total company investment earnings and administrative expenses when allocating the administrative expenses to the Medicare segment during the period of January 1, 2006, to September 30, 2006. Arizona identified Medicare segment pension assets of \$2,180,138; however, we determined the Medicare segment pension assets were \$2,178,510 as of September 30, 2006. As a result, Arizona overstated the Medicare segment pension assets by \$1,628.

Appendix A presents details on the Medicare segment's pension assets from January 1, 2005, to September 30, 2006, as determined during our audit. Table 1 summarizes the audit adjustment required to update Medicare segment pension assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments			
	Per OIG	Per Arizona	Difference
Prior Audit Recommendation	\$1,467,736	\$1,467,736	\$0
Update of Medicare Segment Assets			
Administrative Expenses	(12,563)	(10,935)	(1,628)
Under/(Over)statement of Medicare Segment Pension Assets			(\$1,628)

In addition, the CAS requires a segment closing adjustment to be made in order to recognize Medicare's share of the excess liabilities as a result of the termination of the Medicare contracts. Arizona did not calculate Medicare's share of the excess pension liabilities; however, we calculated Medicare's share of the excess pension liabilities to be \$244,359 as of September 30, 2006. Accordingly, we determined that Arizona understated Medicare's share of the excess pension liabilities, due to the termination of the Medicare contracts, by \$244,359.

PRIOR AUDIT RECOMMENDATION

Arizona properly implemented the prior audit recommendation (A-07-06-00207) which recommended that Arizona decrease Medicare segment pension assets by \$6,070, and recognize \$1,467,736 of Medicare segment pension assets as of January 1, 2005.

UPDATE OF MEDICARE SEGMENT ASSETS

Federal Requirements

The Medicare contracts state that “. . . the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7).” CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses. The CAS requires expenses to be allocated among the segments in proportion to the investment earnings.

Administrative Expenses Understated

Arizona understated administrative expenses by \$1,628 for the Medicare segment. This understatement occurred because Arizona used the total company investment earnings and administrative expenses for the entire calendar year 2006 (12 months), instead of using the total company investment earnings and administrative expenses for the period January 1, 2006, to September 30, 2006 (9 months) when allocating the January 1, 2006, to September 30, 2006, administrative expenses to the Medicare segment. As a result, Arizona overstated the Medicare segment pension assets by \$1,628.

EXCESS PENSION LIABILITIES

Cost Accounting Standards

CAS 413-50(c)(12), which addresses contract terminations and segment closings, 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

(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 [48 CFR §] 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.

CAS 413.50(c)(12)(vi) addresses the methodology for determining the Federal Government's share of the excess pension liabilities, and 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 Medicare Segment Pension Liabilities as of September 30, 2006

Arizona identified \$247,286 of excess Medicare segment pension liabilities as of September 30, 2006. However, we calculated \$248,914 of excess Medicare segment pension liabilities as of that same date. (See Table 2.) Therefore, Arizona understated the excess Medicare segment pension liabilities by \$1,628. The understatement occurred because of the adjustment made during the update of assets related to the administrative expenses, as discussed earlier.

Medicare's Share of Excess Medicare Segment Pension Liabilities

Arizona did not comply with the Medicare contracts in determining Medicare's share of the excess pension liabilities as of September 30, 2006. Arizona did not calculate Medicare's share of the excess pension liabilities; however, we calculated that Medicare's share of the excess pension liabilities was \$244,359. As a result, Arizona understated Medicare's share of the excess pension liabilities by \$244,359.

We calculated the aggregate Medicare percentage (see Appendix B) and applied it to the Medicare segment's excess liabilities to determine the correct amount of Medicare's share of the excess liabilities. Table 2 presents the calculation of Medicare's share of the excess liabilities.

Medicare Segment Pension Assets as of September 30, 2006	\$2,178,510
Medicare Segment Actuarial Liabilities as of September 30, 2006	2,427,424
Excess Medicare Segment Pension Assets/(Liabilities)	<u>(248,914)</u>
Aggregate Medicare Percentage	98.17%
Medicare's Share of Excess Pension Liabilities	<u>(\$244,359)</u>
Per OIG Amount Due to Arizona	(\$244,359)
Amount Reimbursed to Arizona	<u>0</u>
Difference	<u>(\$244,359)</u>

RECOMMENDATIONS

We recommend that Arizona:

- decrease the Medicare segment pension assets by \$1,628 as of September 30, 2006, and
- recognize \$244,359 as Medicare's share of the excess pension liabilities due to the segment closing calculation.

AUDITEE COMMENTS

In written comments on our draft report, Arizona agreed with our recommendations and stated that it will work with CMS on settlement of the Final Administrative Cost Proposal for FY 2006 to:

- decrease the Medicare segment pension assets by \$1,628 as of September 30, 2006, and
- recognize \$244,359 as Medicare's share of the Medicare segment excess pension liabilities due to the segment closing calculations.

Arizona's comments are included in their entirety as Appendix C.

APPENDIXES

Blue Cross Blue Shield of Arizona
Statement of Market Value of Pension Assets
For the Period
January 1, 2005, to September 30, 2006

Description	Total Company	Other Segment	Medicare
Assets January 1, 2005	<u>1/</u> \$88,800,584	\$87,332,848	\$1,467,736
Prepayment Credits	<u>2/</u> 0	(295,693)	295,693
Contributions	<u>3/</u> 11,941,123	11,941,123	0
Earnings	<u>4/</u> 7,015,215	6,871,424	143,791
Benefit Payments	<u>5/</u> (5,534,206)	(5,534,206)	0
Expenses	<u>6/</u> (338,536)	(331,597)	(6,939)
Transfers	<u>7/</u> 0	75,070	(75,070)
Assets January 1, 2006	101,884,180	100,058,969	1,825,211
Prepayment Credits	0	(227,070)	227,070
Contribution	0	0	0
Earnings	6,432,376	6,300,523	131,853
Benefit Payments	(3,529,544)	(3,529,544)	0
Expenses	(274,385)	(268,761)	(5,624)
Assets September 30, 2006	\$104,512,627	\$102,334,117	\$2,178,510
Per Arizona	<u>8/</u> \$104,512,627	\$102,332,489	\$2,180,138
Asset Variance	<u>9/</u> \$0	\$1,628	(\$1,628)

FOOTNOTES

- 1/ We determined the Medicare segment pension assets as of January 1, 2005, based upon our prior segmentation audit (A-07-06-00207). 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/ Prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current year contributions. Prepayment credits are maintained in the Other segment and transferred to the Medicare segment as needed to cover funding requirements.
- 3/ 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 costs in the future.

Blue Cross Blue Shield of Arizona
Statement of Market Value of Pension Assets
For the Period
January 1, 2005, to September 30, 2006

- 4/ We obtained investment earnings from actuarial valuation reports. 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).
- 5/ We based the Medicare segment's benefit payments on actual payments to Medicare retirees. Blue Cross Blue Shield of Arizona (Arizona) provided us with supporting documentation for the benefit payment amounts made to plan retirees.
- 6/ We allocated administrative expenses to the Medicare segment in proportion to investment earnings.
- 7/ We identified participant transfers between segments based on the participant data files provided by Arizona's actuarial consulting firm. Asset transfers were equal to the accrued actuarial liability determined under the accrued benefit cost method in accordance with the CAS.
- 8/ We obtained the asset amounts as of September 30, 2006, prior to the transfer adjustment, from the actuarial valuation report prepared by Arizona's actuarial consulting firm.
- 9/ The asset variance represents the difference between our calculation of Medicare segment pension assets and Arizona's calculation of the Medicare segment pension assets.

**Blue Cross Blue Shield of Arizona
Calculation of the Aggregate Medicare Percentage**

APPENDIX B

Fiscal Year	Medicare Segment Pension Costs Claimed for Medicare	Total Medicare Segment Pension Costs	Aggregate Medicare Percentage¹
1991	\$239	\$246	
1992	0	0	
1993	0	0	
1994	66,122	66,979	
1995	20,890	22,326	
1996	0	0	
1997	0	0	
1998	0	0	
1999	0	0	
2000	31,342	32,604	
2001	106,525	109,167	
2002	144,274	146,829	
2003	202,952	205,646	
2004	240,933	245,175	
2005	280,967	284,870	
2006	294,732	300,993	
Total	\$1,388,976	\$1,414,835	98.17% ²

¹The aggregate percentage was based on the audited pension costs as determined during the pension audits related to the Arizona Medicare segment. The information for fiscal years (FY) 1991 - 2005 was obtained during our prior audit (A-07-06-00216). The information for FY 2006 was obtained during the current review (A-07-09-00307).

²We calculated the aggregate Medicare percentage by dividing the Medicare segment pension costs claimed for Medicare reimbursement (numerator) by the total Medicare segment pension costs (denominator) pursuant to CAS 413.



An Independent Licensee
of the Blue Cross and
Blue Shield Association

March 30, 2009

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

Refer to: A-07-09-00306

Dear Mr. Cogley:


The purpose of this letter is to submit our response to the Department of Health and Human Services Office of Inspector General's draft report entitled "Review of the Pension Segmentation Requirements for the Qualified Pension Plan at Blue Cross Blue Shield of Arizona, a Terminated Medicare Contractor, for the Period January 1, 2005 to September 30, 2006."

We agree with the report recommendations and will work with the Centers for Medicare and Medicaid Services on settlement of the Final Administrative Cost Proposal for FY 2006 to:

- Decrease the Medicare segment pension assets by \$1,628 as of September 30, 2006, and
- Recognize \$244,359 as Medicare's share of the Medicare segment excess pension liabilities due to the segment closing calculations.

We appreciate the opportunity to review and provide our comments prior to release of the final report. If you have any questions regarding our response, please contact Marty O'Reilly at 602-864-5393.

Sincerely


Suzy Mortenson
Director of Finance

Cc: Jay Pinkerton, JP Morgan Chase
Megan Seehafer, OIG/OAS
Jeffrey Wilson, OIG/OAS
Eric Shipley, CMS
Hazel Johnson, CMS
Rosalia Teran, CMS
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