DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

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

October 2, 2008

Report Number: A-07-07-00240

Mr. Steve D. Cox, CPA, CEBS
Director of Benefits Finance
Nationwide Mutual Insurance Company
One Nationwide Plaza
Columbus, Ohio 43125-2220

Dear Mr. Cox:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of Pension Costs Claimed for Medicare Reimbursement by Nationwide Mutual Insurance Company for Fiscal Years 1987 Through 2002." 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.

Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5). Accordingly, this report will be posted on the Internet at http://oig.hhs.gov.

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or your staff may 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-07-07-00240 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Ms. Nanette Foster Reilly
Consortium Administrator
Consortium for Financial Management & Fee for Service Operations
Centers for Medicare & Medicaid Services
601 East 12th Street, Room 235
Kansas City, Missouri 64106

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF PENSION COSTS CLAIMED FOR MEDICARE REIMBURSEMENT BY NATIONWIDE MUTUAL INSURANCE COMPANY FOR FISCAL YEARS 1987 THROUGH 2002

Daniel R. Levinson
Inspector General

October 2008
A-07-07-00240

Office of Inspector General

http://oig.hhs.gov

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Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, Office of Inspector General reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5).

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

Nationwide Mutual Insurance Company (Nationwide) administered Medicare Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until the contractual relationship was terminated June 30, 2002. The effective closing date for the Medicare segment was June 30, 2002.

Medicare reimburses a portion of the annual contributions that contractors make to their pension plans. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation, Cost Accounting Standards (CAS), and Medicare contracts.

The Medicare contracts require contractors to allocate or separately calculate pension costs. Contractors must use the separate calculation method if there is a material difference between the results of the two methods.

OBJECTIVE

Our objective was to determine the allowability of pension costs that Nationwide claimed for Medicare reimbursement for fiscal years (FY) 1987 through 2002.

SUMMARY OF FINDING

Nationwide claimed $415,080 of unallowable Medicare pension costs for FYs 1987 through 2002. This occurred primarily because Nationwide used the Financial Accounting Standard No. 87 expense in calculating allowable pension costs instead of allocating or separately computing pension costs in accordance with CAS 412 and 413, as required by the Medicare contract. Consequently, Nationwide claimed $11,719,064 of pension costs for Medicare reimbursement; however, we calculated that allowable pension costs during this period totaled $11,303,984.

RECOMMENDATION

We recommend that Nationwide revise its Final Administrative Cost Proposals for FYs 1987 through 2002 or otherwise credit CMS to reduce its claimed pension costs by $415,080.

AUDITEE COMMENTS

In written comments on our draft report, Nationwide did not address our recommendation. Nationwide disagreed with our finding, calculations, valuation methods, and the applicability of some of the criteria we used. Nationwide's comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing Nationwide's comments, we made a revision to our calculations and the related recommendation. Our finding and recommendation, as revised, are valid.

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INTRODUCTION

BACKGROUND

Nationwide

Nationwide Mutual Insurance Company (Nationwide) administered Medicare Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until the contractual relationship was terminated June 30, 2002. The effective closing date for the Medicare segment was June 30, 2002.

Medicare Reimbursement of Pension Costs

Medicare reimburses a portion of the annual contributions that contractors make to their pension plans. To be allowable for Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with Cost Accounting Standards (CAS) 412 and 413 and (2) funded as specified by part 31 of the Federal Acquisition Regulation (FAR).

Beginning with fiscal year (FY) 1988, CMS incorporated specific segmentation language into Medicare contracts that requires contractors to use either an allocation method or a separate calculation method to identify and claim pension costs for Medicare reimbursement. Under the allocation method, the contractor determines total plan CAS pension costs and allocates a share to Medicare. Under the separate calculation method, the contractor separately identifies the pension cost components for the Medicare segment. The contractor must use the separate calculation method if its result is materially different from that of the allocation method.

Federal Requirements

The Medicare contracts address the determination and allocation of pension costs. Appendix B, section XVI of the contracts state: "The calculation of and accounting for pension costs charged to this agreement/contract are governed by the Federal Acquisition Regulation and Cost Accounting Standards 412 and 413."

FAR 31.205-6(j) addresses allowability of pension costs and requires that plan contributions substantiate pension costs assigned to contract periods.

CAS 412 regulates the determination and measurement of pension cost components. It also regulates 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.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine the allowability of pension costs that Nationwide claimed for Medicare reimbursement for FYs 1987 through 2002.

Scope

We reviewed pension costs that Nationwide claimed for Medicare reimbursement on its Final Administrative Cost Proposals (FACP) for FYs 1987 through 2002. Achieving the objective did not require that we review Nationwide's overall internal control structure. However, we did review the internal controls related to the pension costs claimed for Medicare reimbursement to ensure that the pension costs were allocable in accordance with the CAS and allowable in accordance with the FAR.

We performed fieldwork at Nationwide in Columbus, Ohio.

Methodology

We identified Nationwide's CAS pension costs for the total company and the Medicare segment. We also determined the extent to which Nationwide funded CAS pension costs with contributions to the pension trust fund and accumulated prepayment credits. We based the calculations on separately computed CAS pension costs for the Medicare segment and total company CAS pension costs. The CMS Office of the Actuary calculated the allocable CAS pension costs based on Nationwide's historical practices and on the results of our segmentation review, "Review of the Qualified Pension Plan at Nationwide Mutual Insurance Company, a Terminated Medicare Contractor, for the Period March 1, 1986, to June 30, 2002" (A-07-07-00239). Appendix A contains details on the pension costs and contributions.

In performing our review, we used information that Nationwide's actuarial consulting firm and internal actuarial department provided. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We examined Nationwide's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s.

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

FINDING AND RECOMMENDATION

UNALLOWABLE PENSION COSTS

Nationwide claimed $415,080 of unallowable Medicare pension costs for FYs 1987 through 2002.[1]

For FYs 1987 through 2002, Nationwide claimed pension costs of $11,719,064 for Medicare reimbursement.[2] We calculated the allowable costs based on separately computed CAS pension costs for the Medicare segment and the total company. We determined that the allowable CAS pension costs during this period totaled $11,303,984.

We compared allowable CAS pension costs with the pension costs claimed on Nationwide's FACPs, as shown in the table below.

Cost Claimed Variance			
Fiscal Year	**Per Nationwide**	**Per Audit**	**Difference**
1987	$468,953	$468,953	$0
1988	291,020	152,735	138,285
1989	441,528	446,033	(4,505)
1990	549,410	1,002,027	(452,617)
1991	914,901	1,209,011	(294,110)
1992	946,597	1,153,031	(206,434)
1993	1,242,912	1,275,679	(32,767)
1994	1,618,397	1,730,290	(111,893)
1995	1,644,417	1,916,384	(271,967)
1996	1,241,707	1,448,849	(207,142)
1997	986,536	456,197	530,339
1998	675,512	44,795	630,717
1999	697,174	0	697,174
2000	0	0	0
2001	0	0	0
2002	0	0	0
Total	**$11,719,064**	**$11,303,984**	**$415,080**

[1]Because the Medicare contract was terminated June 30, 2002, the calculation of the allowable FY 2002 costs covered the period October 1, 2001, through June 30, 2002.

[2]The pension costs that Nationwide claimed included only the actual costs for which Nationwide was reimbursed. For FY 2002, Nationwide calculated $722,157 of allowable pension costs; however, it has not claimed those costs for reimbursement. Based upon this audit, we determined that the allowable costs were zero.

The Medicare contracts required Nationwide to allocate or separately calculate CAS pension costs for Medicare reimbursement. However, Nationwide did not base its claim for Medicare reimbursement on either allocated or separately calculated CAS pension costs. Instead, it based its claim on the Financial Accounting Standard No. 87 expense developed for financial reporting purposes. As a result, Nationwide claimed $415,080 of unallowable pension costs.

RECOMMENDATION

We recommend that Nationwide revise its FACPs for FYs 1987 through 2002 or otherwise credit CMS to reduce its claimed pension costs by $415,080.

AUDITEE COMMENTS

In written comments on our draft report, Nationwide did not address our recommendation. Nationwide disagreed with our finding, calculations, valuation methods, and the applicability of some of the criteria we used.

A summary of Nationwide's comments follows:

- Nationwide did not agree with the determination of the FYs 1987 and 1988 allowable pension costs. Nationwide stated that its "good faith effort to comply" with claiming pension costs for periods prior to FY 1988 did not require Nationwide to claim pension costs on a segmented basis.

- Nationwide did not agree with the amount of pension costs claimed by Nationwide for FY 1995. Nationwide stated that the pension cost claimed by Nationwide for FY 1995 was $1,644,417 rather than, as our draft report specified, $1,644,471.

- Nationwide did not agree that the 2002 pension costs were $0. Nationwide stated that we calculated the 2002 pension costs to be $0 because we did not recognize the 2002 contributions. Nationwide calculated the 2002 pension costs to be $722,157.

Nationwide questioned whether our audit approach complied with the independence requirements imposed by GAGAS. Specifically, Nationwide stated that we engaged the Office of the Actuary within CMS (a party to the Medicare contracts) to independently calculate Nationwide's pension costs and that we accepted those calculations as correct.

Nationwide's comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing Nationwide's comments, we made a revision to our calculations and the related recommendation. Our finding and recommendation, as revised, are valid.

With respect to Nationwide's more specific comments:

- After further review of Nationwide's claim of pension costs for FYs 1987 and 1988, we partially agree with Nationwide. Nationwide used a "good faith effort" to comply with claiming pension costs. In addition, the Medicare contract did not require segmented pension costs until the first plan year starting in FY 1988. Therefore, the $621,688 in pension costs claimed by Nationwide from October 1, 1986, through February 1, 1988, is allowable. However, the FY 1988 pension costs associated with the period March 1, 1988, through September 30, 1988, were required to be computed using separately computed CAS pension costs. Nationwide did not fund these costs; therefore, the $138,285 in pension costs claimed by Nationwide from March 1, 1988, through September 30, 1988, were unallowable.

- We agree that the pension cost claimed by Nationwide for FY 1995 was $1,644,417.

- We disagree with Nationwide's assertion that pension costs for FY 2002, totaling $722,157, were allowable. We continue to find that the FY 2002 pension costs were zero, as a result of the adjustments made to the Medicare segment assets, adjustments that we discussed in our segmentation review (A-07-07-00239). These adjustments resulted in an increase in the Medicare segment actuarial value of assets used to calculate the assignable pension costs. Therefore, the Medicare segment's actuarial value of assets exceeded the Medicare segment's actuarial accrued liabilities plus current normal cost, resulting in the assignable pension costs for FY 2002 being zero. In addition, since there were sufficient assets to cover the actuarial accrued liabilities plus current normal cost, the handling of the 2002 contribution had no impact on the FY 2002 allowable costs.

With respect to Nationwide's concerns as to the independence requirements that GAGAS imposes on the audit process, GAGAS allow the use of specialists (including actuaries) to assist in performing audits. We performed specific tests to determine that the CMS Office of the Actuary was, in fact, independent. Furthermore, we critically reviewed the actuary's calculations. Our review complied with all GAGAS requirements.

APPENDIXES

NATIONWIDE MUTUAL INSURANCE COMPANY
STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEARS 1987–2002

Date	Description		Total Company	Other Segment	Medicare Segment
1987	FY Allowable Pension Costs	1/	NA	NA	468,953

Date	Description		Total Company	Other Segment	Medicare Segment
1989	Contributions	2/	$0	$0	$0
7.00%	Discount for Interest	3/	0	0	0
3/1/88	Present Value Contributions	4/	0	0	0
	Prepayment Credit	5/	0	0	0
	Present Value of Funding	6/	0	0	0
3/1/88	CAS Funding Target	7/	28,049,734	27,010,966	1,038,768
	Percentage Funded	8/		0.00%	0.00%
	Funded Pension Cost	9/		0	0
	Allowable Interest	10/		0	0
	Allocable Pension Cost	11/		0	0
1988	Fiscal Year Pension Cost	12/		0	152,735
	Medicare LOB* Percentage	13/		0.00%	100.00%
	Allowable Pension Cost	14/	$152,735	$0	$152,735

1989	Contributions		$17,564,538	$16,922,794	$641,744
8.00%	Discount for Interest		(1,059,891)	(1,021,166)	(38,725)
3/1/89	Present Value Contributions		16,504,647	15,901,628	603,019
	Prepayment Credit		0	0	0
	Present Value of Funding		16,504,647	15,901,628	603,019
3/1/89	CAS Funding Target		22,935,361	22,097,387	837,974
	Percentage Funded			71.96%	71.96%
	Funded Pension Cost			15,901,280	603,006
	Allowable Interest			901,073	34,170
	Allocable Pension Cost	15/		16,802,353	637,176
1989	Fiscal Year Pension Cost	16/		11,761,647	446,023
	Medicare LOB Percentage			0.00%	100.00%
	Allowable Pension Cost	17/	$446,023	$0	$446,023

Date	Description		Total Company	Other Segment	Medicare Segment
1990	Contributions		$36,952,880	$35,847,845	$1,105,035
8.00%	Discount for Interest		(2,737,250)	(2,655,396)	(81,854)
1/1/90	Present Value Contributions		34,215,630	33,192,449	1,023,181
	Prepayment Credit		0	0	0
	Present Value of Funding		34,215,630	33,192,449	1,023,181
1/1/90	CAS Funding Target		25,314,191	24,291,010	1,023,181
	Percentage Funded			100.00%	100.00%
	Funded Pension Cost			24,291,010	1,023,181
	Allowable Interest			1,376,491	57,980
	Allocable Pension Cost			25,667,501	1,081,161
1990	Fiscal Year Pension Cost	18/		24,291,332	1,002,024
	Medicare LOB Percentage			0.00%	100.00%
	Allowable Pension Cost		$1,002,024	$0	$1,002,024

1991	Contributions		$35,446,721	$34,551,737	$894,984
8.00%	Discount for Interest		(2,607,303)	(2,541,472)	(65,831)
1/1/91	Present Value Contributions		32,839,418	32,010,265	829,153
	Prepayment Credit		9,613,554	9,238,065	375,489
	Present Value of Funding		42,452,972	41,248,330	1,204,642
1/1/91	CAS Funding Target		30,842,173	29,637,531	1,204,642
	Percentage Funded			100.00%	100.00%
	Funded Pension Cost			29,637,531	1,204,642
	Allowable Interest			1,155,970	46,985
	Allocable Pension Cost			30,793,501	1,251,627
1991	Fiscal Year Pension Cost	19/		29,512,001	1,209,011
	Medicare LOB Percentage			0.00%	100.00%
	Allowable Pension Cost		$1,209,011	$0	$1,209,011

NATIONWIDE MUTUAL INSURANCE COMPANY
STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEARS 1987–2002

Date	Description	Total Company	Other Segment	Medicare Segment
1992	Contributions	$0	$0	$0
8.00%	Discount for Interest	0	0	0
1/1/92	Present Value Contributions	0	0	0
	Prepayment Credit	1,734,286	621,843	1,112,443
	Present Value of Funding	1,734,286	621,843	1,112,443
1/1/92	CAS Funding Target	1,734,286	621,843	1,112,443
	Percentage Funded		100.00%	100.00%
	Funded Pension Cost		621,843	1,112,443
	Allowable Interest		0	0
	Allocable Pension Cost		621,843	1,112,443
1992	Fiscal Year Pension Cost		8,164,758	1,147,239
	Medicare LOB Percentage		0.00%	100.00%
	Allowable Pension Cost	$1,147,239	$0	$1,147,239

1993	Contributions	$38,090,934	$37,209,843	$881,091
8.00%	Discount for Interest	(2,418,069)	(2,362,136)	(55,933)
1/1/93	Present Value Contributions	35,672,865	34,847,707	825,158
	Prepayment Credit	11,669,806	11,229,117	440,689
	Present Value of Funding	47,342,671	46,076,824	1,265,847
1/1/93	CAS Funding Target	33,520,630	32,254,783	1,265,847
	Percentage Funded		100.00%	100.00%
	Funded Pension Cost		32,254,783	1,265,847
	Allowable Interest		1,191,454	46,759
	Allocable Pension Cost		33,446,237	1,312,606
1993	Fiscal Year Pension Cost		25,240,139	1,262,565
	Medicare LOB Percentage		0.00%	100.00%
	Allowable Pension Cost	$1,262,565	$0	$1,262,565

Date	Description	Total Company	Other Segment	Medicare Segment
1994	Contributions	$61,575,528	$60,270,870	$1,304,658
7.00%	Discount for Interest	(2,802,089)	(2,742,719)	(59,370)
1/1/94	Present Value Contributions	58,773,439	57,528,151	1,245,288
	Prepayment Credit	14,927,804	14,386,796	541,008
	Present Value of Funding	73,701,243	71,914,947	1,786,296
1/1/94	CAS Funding Target	49,288,501	47,502,205	1,786,296
	Percentage Funded		100.00%	100.00%
	Funded Pension Cost		47,502,205	1,786,296
	Allowable Interest		1,578,814	59,370
	Allocable Pension Cost		49,081,019	1,845,666
1994	Fiscal Year Pension Cost		45,172,324	1,712,401
	Medicare LOB Percentage		0.00%	100.00%
	Allowable Pension Cost	$1,712,401	$0	$1,712,401

1995	Contributions	$69,866,725	$68,771,354	$1,095,371
7.00%	Discount for Interest	(4,460,109)	(4,390,183)	(69,926)
1/1/95	Present Value Contributions	65,406,616	64,381,171	1,025,445
	Prepayment Credit	26,121,633	25,283,200	838,433
	Present Value of Funding	91,528,249	89,664,371	1,863,878
1/1/95	CAS Funding Target	58,069,746	56,205,868	1,863,878
	Percentage Funded		100.00%	100.00%
	Funded Pension Cost		56,205,868	1,863,878
	Allowable Interest		1,533,249	50,845
	Allocable Pension Cost		57,739,117	1,914,723
1995	Fiscal Year Pension Cost		55,574,593	1,897,459
	Medicare LOB Percentage		0.00%	100.00%
	Allowable Pension Cost	$1,897,459	$0	$1,897,459

**NATIONWIDE MUTUAL INSURANCE COMPANY
STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEARS 1987–2002**

Date	Description	Total Company	Other Segment	Medicare Segment
1996	Contributions	$54,252,647	$53,895,678	$356,969
7.00%	Discount for Interest	(3,446,311)	(3,423,635)	(22,676)
1/1/96	Present Value Contributions	50,806,336	50,472,043	334,293
	Prepayment Credit	35,800,598	35,216,764	583,834
	Present Value of Funding	86,606,934	85,688,807	918,127
1/1/96	CAS Funding Target	56,299,415	55,381,288	918,127
	Percentage Funded		100.00%	100.00%
	Funded Pension Cost		55,381,288	918,127
	Allowable Interest		999,824	16,575
	Allocable Pension Cost		56,381,112	934,702
1996	Fiscal Year Pension Cost		56,720,613	1,179,707
	Medicare LOB Percentage		0.00%	100.00%
	Allowable Pension Cost	$1,179,707	$0	$1,179,707

1997	Contributions	$43,692,730	$43,624,301	$68,429
7.00%	Discount for Interest	(2,856,116)	(2,851,643)	(4,473)
1/1/97	Present Value Contributions	40,836,614	40,772,658	63,956
	Prepayment Credit	32,429,046	32,323,640	105,406
	Present Value of Funding	73,265,660	73,096,298	169,362
1/1/97	CAS Funding Target	52,105,740	51,936,378	169,362
	Percentage Funded		100.00%	100.00%
	Funded Pension Cost		51,936,378	169,362
	Allowable Interest		972,465	3,171
	Allocable Pension Cost		52,908,843	172,533
1997	Fiscal Year Pension Cost		53,776,910	363,075
	Medicare LOB Percentage		0.00%	100.00%
	Allowable Pension Cost	$363,075	$0	$363,075

Date	Description	Total Company	Other Segment	Medicare Segment
1998	Contributions	$80,037,311	$80,037,311	$0
6.00%	Discount for Interest	(4,516,823)	(4,516,823)	0
1/1/98	Present Value Contributions	75,520,488	75,520,488	0
	Prepayment Credit	22,641,114	22,641,114	0
	Present Value of Funding	98,161,602	98,161,602	0
1/1/98	CAS Funding Target	65,697,883	65,697,883	0
	Percentage Funded		100.00%	0.00%
	Funded Pension Cost		65,697,883	0
	Allowable Interest		1,829,913	0
	Allocable Pension Cost		67,527,796	0
1998	Fiscal Year Pension Cost		63,873,058	43,133
	Medicare LOB Percentage		0.00%	100.00%
	Allowable Pension Cost	$43,133	$0	$43,133

1999	Contributions	$0	$0	$0
6.00%	Discount for Interest	0	0	0
1/1/99	Present Value Contributions	0	0	0
	Prepayment Credit	0	0	0
	Present Value of Funding	0	0	0
1/1/99	CAS Funding Target	0	0	0
	Percentage Funded		0.00%	0.00%
	Funded Pension Cost		0	0
	Allowable Interest		0	0
	Allocable Pension Cost		0	0
1999	Fiscal Year Pension Cost		16,881,949	0
	Medicare LOB Percentage		0.00%	100.00%
	Allowable Pension Cost	$0	$0	$0

Date	Description	Total Company	Other Segment	Medicare Segment
2000	Contributions	$0	$0	$0
6.00%	Discount for Interest	0	0	0
1/1/00	Present Value Contributions	0	0	0
	Prepayment Credit	0	0	0
	Present Value of Funding	0	0	0
1/1/00	CAS Funding Target	0	0	0
	Percentage Funded		0.00%	0.00%
	Funded Pension Cost		0	0
	Allowable Interest		0	0
	Allocable Pension Cost		0	0
2000	Fiscal Year Pension Cost		0	0
	Medicare LOB Percentage		0.00%	100.00%
	Allowable Pension Cost	$0	$0	$0

2001	Contributions	$0	$0	$0
6.00%	Discount for Interest	0	0	0
1/1/01	Present Value Contributions	0	0	0
	Prepayment Credit	0	0	0
	Present Value of Funding	0	0	0
1/1/01	CAS Funding Target	0	0	0
	Percentage Funded		0.00%	0.00%
	Funded Pension Cost		0	0
	Allowable Interest		0	0
	Allocable Pension Cost		0	0
2001	Fiscal Year Pension Cost		0	0
	Medicare LOB Percentage		0.00%	100.00%
	Allowable Pension Cost	$0	$0	$0

Date	Description	Total Company	Other Segment	Medicare Segment
2002	Contributions	$0	$0	$0
6.00%	Discount for Interest	0	0	0
1/1/02	Present Value Contributions	0	0	0
	Prepayment Credit	40,984,699	40,984,699	0
	Present Value of Funding	40,984,699	40,984,699	0
1/1/02	CAS Funding Target	58,698,611	58,698,611	0
	Percentage Funded		69.82%	0.00%
	Funded Pension Cost		40,983,370	0
	Allowable Interest		0	0
	Allocable Pension Cost		40,983,370	0
2002	Fiscal Year Pension Cost		30,737,528	0
	Medicare LOB Percentage		0.00%	100.00%
	Allowable Pension Cost	$0	$0	$0

* Line of business.

FOOTNOTES

1/ We obtained the fiscal year (FY) 1987 allowable pension costs from documentation provided by Nationwide. The Medicare contract did not require separately computed pension costs until the first plan starting in FY 1988; therefore, we considered Nationwide's pension cost claimed for the Medicare segment to be allowable. It was Nationwide's choosen methodology not to claim indirect pension costs.

2/ We obtained Total Company contribution amounts and dates of deposit from Internal Revenue Service 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. We determined the contributions allocated to the Medicare segment during the pension segmentation review (A-07-07-00239). The amounts shown for the Other segment represent the difference between the Total Company and the Medicare segment.

3/ We subtracted the interest that is included in the contributions deposited after the beginning of the valuation year to discount the contributions back to their beginning-of-the-year value. For plan years 1987 through 1989, the plan year started on March 1, and for plans years 1990 through 2002, the plan year started on January 1. For purposes of this Appendix, we computed the interest as the difference between the present value of contributions (at the valuation interest rate) and actual contribution amounts.

4/ The present value of contributions is the value of the contributions discounted from the date of deposit back to the first day of the plan year. 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, consistent with the method mandated by Employee Retirement Income Security Act.

5/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year Cost Accounting Standards (CAS) funding target. A prepayment credit may be carried forward, with interest, to fund future CAS pension costs.

6/ 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 the first day of the plan year for each year.

7/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of the Federal Acquisition Regulation (FAR) 31.205-6(j)(2)(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. Because any funding in excess of the CAS funding target is considered premature funding in accordance with CAS 412.50(c)(1) (as amended), 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 cost as the CAS funding target multiplied by the percent funded.

10/ We assumed that interest on the funded CAS pension cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(j)(2)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target, less the prepayment credit, 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 that may be allocated for contract cost purposes.

12/ We converted the plan year (March 1 through February 28) allocable pension costs to a Federal fiscal year (FY) basis (October 1 through September 30). We calculated the FY pension costs as 5/12 of the prior year's costs plus 7/12 of the current year's costs. Costs 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 segment based upon the documentation provided by Nationwide. We determined that it was Nationwide's methodology to claim 100% of the allocable pension costs for the Medicare segment and to claim no portion of the other segment allocable pension costs. We used Nationwide's methodology to determine the allowable pension costs.

14/ For FY 1988 allowable penson costs, we obtained the October 1987 through February 1988 allowable pension costs of $152,735, from documentation provided by Nationwide. The Medicare contract did not required separately computed pension costs until the first plan starting in FY 1988; however, from March 1988 through September 1988 the allowable pension costs were zero.

15/ Nationwide changed its plan year start date from March 1 to January 1, as of January 1, 1990. Therefore, the 1989 allocable pension costs were for only a 10-month period.

16/ The 1989 allocable pension costs were for a 10-month period. To calculate the FY 1989 allocable pension costs, we calculated the FY pension costs as 5/12 of the prior year's costs plus 7/10 of the current year's costs.

17/ We computed the allowable Medicare pension cost as the FY pension cost multiplied by the Medicare line of business percentage.

18/ As stated above in footnote 16, the 1989 allocable pension costs were for a 10-month period. To calculate the FY 1990 allocable pension costs, we calculated the FY pension costs as 3/10 of the prior year's costs plus 9/12 of the current year's costs.

19/ Starting with FY 1991, we converted the plan year (January 1 through December 31) allocable pension costs to an FY basis (October 1 through September 30). We calculated the FY pension costs as 1/4 of the prior year's costs plus 3/4 of the current year's costs.

Nationwide

Office of General Counsel

On Your Side™

April 3, 2008

Mr. Patrick J. Cogley
Regional Inspector General for Audit Services
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Dear Mr. Cogley:

Nationwide Mutual Insurance Company ("Nationwide") appreciates this opportunity to submit comments on draft audit reports prepared by the Office of the Inspector General ("OIG") related to the Nationwide Retirement Plan ("Plan"). These draft audit reports, "Review of the Qualified Pension Plan at Nationwide Mutual Insurance Company, a Terminated Medicare Contractor, for the Period March 1, 1986, to June 30, 2002," No. A-07-07-00239 ("Segmentation Report") and "Review of Pension Costs Claimed for Medicare Reimbursement by Nationwide Mutual Insurance Company for Fiscal Years 1987 through 2002," No. A-07-07-00240 ("Cost Report"), pertain to Nationwide's May 10, 2004 submission to the Centers for Medicaid and Medicare Services ("CMS"), which Nationwide provided for settlement purposes ("Submission").[1] Because the issues raised in the Segmentation Report and the Cost Report (collectively, the "Draft Reports") are interrelated, this letter offers Nationwide's consolidated comments.

Background

In July of 1966, Nationwide and the Secretary of Health, Education, and Welfare (which later became the Department of Health and Human Services; collectively "HHS") executed Agreement No. SSA-66-311-2 for certain Medicare Part B work. The parties subsequently executed amended contracts in January/February of 1973 (Agreement No. SSA-70-311-2), June of 1973 (Agreement No. SSA-73-311-2), December of 1976 (Agreement No. SSA-76-311-2), and December of 1978 (Agreement No. HCFA 78-311-2).

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[1] A March 24, 2006 letter from John McQuade (Pine Cliff Consulting Inc.) to Eric Shipley (CMS Office of the Actuary) provided additional information on behalf of Nationwide concerning the retirement age assumption. Nationwide understands that there are no outstanding differences between the parties with regard to the issues discussed in that letter.

In or around June 1981, Nationwide and HHS executed Contract No. HCFA 80-311-2. The executed copy of that Contract provided by HHS does not incorporate Cost Accounting Standard ("CAS") 413. HHS provided a separate, unsigned document, entitled "Appendix B (10-80) (Intermediary, Plan and Carrier Agreements) Principles of Reimbursement of Administrative Costs." Section 1118.7 of that document incorporated CAS 412 and 413.[2]

In 1986, Nationwide and HHS executed another Medicare Part B agreement, Contract No. HCFA 84-311-2. Although the parties executed the Contract in 1986, Article XXVI states that the term of the Contract was October 1, 1984 through September 30, 1985, and that it would be automatically renewed for one-year periods unless one of the parties provided written notice not to renew the Contract. Appendix B to that Contract states that allowable and allocable costs will be determined in accordance with Federal Acquisition Regulation ("FAR") Part 31 in effect on April 1, 1984, subject to limitations of the Contract.

In 1987, Nationwide and HHS executed another Medicare Part B agreement, Contract No. HCFA-87-311-2 ("1987 Contract"). That was the last Medicare Contract the parties executed. Moreover, Nationwide entered into no other federal government contracts or subcontracts after executing the 1987 Contract. Article XXVI of the 1987 Contract states that the term began on October 1, 1987 and ended on September 30, 1988, and would be automatically renewed for one-year periods unless one of the parties provided written notice of an intent not to renew the Contract. As discussed further below, the 1987 Contract incorporated CAS 413.

The parties terminated the 1987 Contract on June 30, 2002. Nationwide made its Submission on May 10, 2004. The OIG provided the Draft Reports on January 8, 2008. The OIG agreed that Nationwide's response to the Draft Reports could be submitted by April 4, 2008.

Areas Of Dispute

The remainder of this letter addresses the errors that Nationwide has identified in the Draft Reports. Nationwide reserves the right to raise additional issues that may arise as a result of its ongoing analysis of the Draft Reports.

I. Pension Costs Incurred Under Pre-CAS Contracts Do Not Increase The Aggregate Medicare Percentage

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[2] As far as we have been able to ascertain, Appendix B was not included in Nationwide's contract. If Appendix B was not included in Nationwide's contract, the OIG's position expressed in the audit report with respect to including the pension costs attributable to this contract in the numerator of the government share fraction would be incorrect.

The parties agree that the closing of Nationwide's Medicare segment resulted in a segment closing under CAS 413. The OIG, however, contends that the closing of the segment also resulted in an "abnormal forfeiture" under a provision that pre-dated the FAR and was allegedly included in contracts in effect from 1966-1981. Based on that contention, the OIG asserts that the numerator of the Medicare share percentage should include pension costs incurred during 1966-1981. See Segmentation Report at 10. Adding the 1966-1981 costs to the numerator substantially increases CMS's share of the segment-closing adjustment.

In particular, the OIG claims that the following clause from the Federal Procurement Regulation ("FPR") supports its view:[3]

> In determining the cost of deferred compensation allowable under the contract, appropriate adjustments shall be made for credits or gains, including those arising out of both normal and abnormal employee turnover, or any other contingencies that can result in forfeiture by employees of such deferred compensation. Adjustments shall be made for forfeitures which directly or indirectly inure to the benefit of the contractor . . . . Adjustments for possible future abnormal forfeitures shall be effected according to the following rules: . . .
>
> (ii) Abnormal forfeitures . . . may be made the subject of agreement between the Government and the contractor either as an equitable adjustment or a method of determining such adjustment.

FPR 1-15.205-6(f)(3) (quoted in Segmentation Report at 7). The OIG offers no explanation as to why a provision from contracts long since closed out has any relevance to the segment closing that occurred in 2002 and that is governed by CAS 413.50(c)(12). As discussed below, there are numerous flaws in that assertion.

At the outset, the plain intent of the FPR "abnormal forfeiture" provision is to address situations "that can result in forfeiture by employees of . . . deferred compensation." Even assuming that the cited FPR language applies to Nationwide, the OIG has neither identified the employees it believes forfeited deferred compensation nor the amounts of those forfeitures. Instead, the OIG merely assumes, without articulating the premise, that the FPR "abnormal forfeiture" requirements are necessarily triggered by a CAS 413 segment closing, and that the amount of CMS entitlement from an "abnormal forfeiture" is determined using calculation principles identical to those contained in CAS 413.50(c)(12). Yet, despite the tight linkage urged by the OIG between the FPR and CAS 413, the FPR "abnormal forfeiture" provision does not refer to CAS 413.50(c)(12), nor does CAS 413.50(c)(12) refer to the FPR "abnormal forfeiture"

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[3] The promulgation of the FAR in 1984 superseded the FPR in its entirety.

provision. Thus, there is no basis in the plain regulatory language for injecting the "abnormal forfeiture" provision into the calculation required by CAS 413.50(c)(12).

In addition, the OIG's reliance on the "abnormal forfeiture" provision overlooks the rules applicable to performing a segment-closing adjustment under CAS 413.50(c)(12). In Teledyne, Inc. v. United States, 50 Fed. Cl. 155 (2001), the Court of Federal Claims set forth those basic rules. The court explained that CAS 413.50(c)(12) prohibits the parties from including in the numerator of the government share fraction any pension costs incurred under pre-CAS contracts: "Thus, neither the government nor the contractor can recover any surplus or deficit attributable to contracts that did not contain the original CAS 413. This includes contracts executed between the parties prior to the first applicable cost accounting period after March 10, 1978, the effective date for CAS 413." Teledyne, 50 Fed. Cl. at 183-84. The Defense Contract Management Agency ("DCMA") and Defense Contract Audit Agency ("DCAA") have acknowledged this clear aspect of the Teledyne decision by noting that the decision bars the inclusion of pre-CAS pension costs as part of the government's share. See DCAA/DCMA Joint Guidance Implementing the Teledyne Decision on CAS 413.50(c)(12) Segment Closing Adjustments at 1 ("the portion of a closed segment's pension surplus or deficit that is attributable to pension costs that were allocated to contracts that predate CAS 413 . . . must be excluded from the calculation of the Government's share of the CAS 413 segment closing adjustment.").

DCMA and DCAA had almost three years to analyze the consequences of the Teledyne decision, yet there is no mention in their Joint Guidance that the FPR "abnormal forfeiture" provision could be used to increase the government's share of an adjustment under CAS 413.50(c)(12). Indeed, we are not aware of any government agency that has ever offered this argument in the roughly thirty years since the CAS Board promulgated CAS 413.50(c)(12) in 1977.

In short, the OIG's novel attempt to apply the "abnormal forfeiture" clause to the CAS segment-closing process is directly contrary to the proper application of CAS 413.50(c)(12).[4]

Nor can Nationwide's pre-CAS contracts provide a mechanism for recovery under the FPR "abnormal forfeiture" provision. During the time that Nationwide's pre-CAS contracts were in force, no abnormal forfeiture occurred, and those contracts have long since been superseded by the 1987 Contract, in which CAS 413.50(c)(12) controls. Moreover, it was not

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[4] Although the revised version of CAS 413 promulgated by the new CAS Board in 1995 does not apply to Nationwide's segment closing for the reasons discussed below, the OIG's Segmentation Report nonetheless relies on New CAS 413. It is therefore noteworthy that New CAS 413.50(c)(12)(vi) also excludes pre-CAS pension costs from the numerator of the government share fraction, and it does not mention the FPR "abnormal forfeiture" provision.

until August 1989 that the FAR was amended to permit the government to recover for the termination of overfunded pension plans. See Teledyne, 50 Fed. Cl. at 166-67.[5]

In addition, the OIG's reliance on the FPR "abnormal forfeiture" provision overlooks the fundamental distinction between cost allocability and cost allowability. Allocability is an accounting concept concerning the relationship between incurred costs and the cost objectives (such as contracts) and activities to which those costs are charged. Cost allowability involves whether a particular cost can be recovered from the government, in whole or in part. See Boeing N. Amer., Inc. v. Roche, 298 F.3d 1274, 1280-81 (Fed. Cir. 2002). The "abnormal forfeiture" provision expressly states that it is an allowability regulation; it begins "In determining the cost of deferred compensation ***allowable under the contract*** . . . ." FPR 1-15.205-6(f)(3) (emphasis added).

The OIG's position amounts to an impermissible attempt to have a cost allowability provision -- the "abnormal forfeiture" provision -- control a question of allocability governed by CAS 413.50(c)(12). The court in Teledyne explained that CAS provisions must prevail in any conflict with inconsistent allowability provisions. See Teledyne, 50 Fed. Cl. at 162 ("This distinction between allocability under the CAS and allowability under the FAR is well recognized. The Federal Circuit has held that with respect to allocation of costs, the CAS supersedes any agency-specific regulation to the extent the regulation is inconsistent with the CAS. Rice v. Martin Marietta Corp., 13 F.3d 1563, 1565 n.2 (Fed.Cir.1993)."). Thus, even assuming for purposes of argument that the "abnormal forfeiture" provision somehow applies to Nationwide's 2002 segment closing, CAS 413 would control over that provision.

II. Nationwide's Contract Is Not Subject To New CAS

The Segmentation Report contends that the ***1995*** revisions to CAS 413 by a new CAS Board govern a segment closing under Nationwide's ***1987*** Contract. The OIG offers no justification for this provision and, as discussed below, there can be no such justification.

Congress established the original CAS Board in 1970 within the Legislative Branch. Pub. L. 91-379, § 719 (1970). Seven years later, the original CAS Board promulgated CAS 413. 42 Fed. Reg. 37,191 (July 20, 1977). Section 413.80 of that Standard specified an effective date of March 10, 1978, and further stated: "This Standard shall be followed by each contractor on or after the start of his next cost accounting period beginning after the receipt of a contract to which this Cost Accounting Standard is applicable." Thus, original CAS 413 applied only after "receipt" of a CAS-covered contract; modifications to pre-existing contracts were insufficient to trigger the new Standard.

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[5] The OIG's reliance on the pre-CAS contracts is particularly problematic in light of its prior representation to Nationwide that Nationwide would not need to produce any documentation for the time period before original CAS 413 was promulgated. See Letter from Thomas J. Prunte to Al Savery (May 6, 1999), at 1. Nationwide relied on that representation.

In 1980, the original CAS Board ceased to exist, and the Defense Department undertook the administration of Standards promulgated by the original Board. 73 Fed. Reg. 8259, 8260 (Feb. 13, 2008).

As discussed above, Nationwide and the government executed Medicare contracts in 1966, 1973, 1976, 1978, 1981, 1986, and 1987. Appendix B to the 1987 Contract states that "in computing and allocating pension costs to [the Contract], the [FAR] and [CAS] 412 and 413 shall apply, and CAS 413 shall be interpreted and applied in accordance with Item XVI of this Appendix B." Item XVI of Appendix B states in part:

> The Secretary and the contractor agree that, for purposes of this agreement/contract, CAS 413 shall be interpreted and applied as specified herein. Neither the Secretary nor the contractor shall seek to apply a different interpretation of the provisions of the CAS addressed below, consistent with applicable statutes and regulations, with respect to this or any prior contract period.

Appendix B at 9. The 1987 Contract terminated on June 30, 2002. Nationwide never received a CAS-covered contract or subcontract after March 30, 1995, the effective date of New CAS 413.

In 1988, Congress created a new CAS Board, this time placing it in the Executive Branch. Pub. L. 100-679 (1988). The new Board undertook the task of addressing certain issues concerning CAS 413 promulgated by the original Board. On March 30, 1995, the new Board promulgated a version of CAS 413 that substantially revised Original CAS 413. See 60 Fed. Reg. 16,534 (Mar. 30, 1995). Section 413.63 of the revised Standard states that the effective date was March 30, 1995, and that the Standard "shall be followed by each contractor on or after the start of its next cost accounting period beginning after the receipt of a contract or subcontract to which this revised Standard applies." Thus, as with Original CAS 413, contractors are not required to follow the revised Standard until they receive a contract or subcontract to which the Standard is applicable, and modifications to pre-existing contracts are insufficient to trigger the revised Standard.

As discussed below, the Segmentation Report contains several allegations that are premised on application of New CAS 413. Yet that Report does not attempt to explain why New CAS 413 applies to the 1987 Contract.[6] Instead, the OIG simply assumes, incorrectly, that New CAS 413 applies. For example, the Segmentation Report states – with no explanation – that Nationwide "did not revalue transfers using the accrued benefit cost method for plan years after

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[6] Indeed, the Audit Report states that "CMS incorporated CAS 412 and 413 into the Medicare contracts ***effective October 1, 1980***," and that, "***[s]tarting in fiscal year 1988***, CMS incorporated segmentation requirements into Medicare contracts" – events that occurred long before promulgation of New CAS 413 in 1995. Segmentation Report at 2 (emphasis added).

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March 31, 1995, ***as required by the revised CAS.***" Segmentation Report at 6 (emphasis added); see also id. ("Nationwide did not use the WAV of assets to allocate earnings for plan years after March 31, 1995, as required by [New] CAS 413.50(c)(7).").

The Segmentation Report's failure to provide any justification for applying New CAS 413 is not surprising, given that the facts and law firmly establish that there is no such justification. The 1987 Contract states that CAS 413 applied to the computation and allocation of pension costs to the Contract, which necessarily referred to original CAS 413. Also, the parties agreed to interpret and apply that version of CAS 413 in accordance with Item XVI of Appendix B, and further agreed that neither party would "seek to apply a different interpretation of the provisions of the CAS addressed below, consistent with applicable statutes and regulations, with respect to this or any prior contract period." Appendix B at 9. Moreover, the 1987 Contract states that it "may be modified at any time by mutual consent of the parties thereto." 1987 Contract at 25. Nationwide and HHS amended the 1987 Contract several times, but never amended it to incorporate the revised CAS 413. See, e.g., Amendment No. 16 (Sept. 7, 2000) (revising period of performance for Contract No. HCFA-87-311-2 to Sept. 7, 2000 through Sept. 30, 2001).

In addition to the fact that the 1987 Contract demonstrates the parties' understanding that New CAS 413 is inapplicable, New CAS 413 itself establishes that it cannot apply. The new CAS Board expressly limited application of the revised Standard to contractors who receive a contract or subcontract to which that Standard applies ***after March 30, 1995***. If the new CAS Board had meant for the revised Standard to apply to ***pre-existing contracts*** that are extended after March 30, 1995, it would have said so. Significantly, the 1987 Contract was Nationwide's only federal government contract between the time the parties executed it in 1987 and the time it was terminated in 2002. Because Nationwide never received a new contract or subcontract subject to New CAS 413 after March 30, 1995, that revised Standard, by its terms, cannot apply.

The Segmentation Report's application of New CAS 413 results in differences from Nationwide's segment-closing adjustment that benefit CMS by over $2 million. This is the type of significant prejudice that the new CAS Board sought to prevent by limiting application to those situations where contractors voluntarily agree to accept a contract subject to the revised Standard ***after*** its effective date. This prejudice flows in part from the material differences between the original CAS 413 – which Nationwide agreed to follow in accordance with additional provisions unique to Medicare contracts – and the revised CAS 413 – which Nationwide never agreed to follow.

III. Funding of 2002 Pension Costs

Nationwide calculated the 2002 CAS pension cost for the Medicare segment to be $722,157. See Submission at S1. In contrast, the OIG's position is that the 2002 CAS cost for the Medicare segment was zero. See Cost Report at 3 n.2. While Nationwide disputes that position, the issue addressed here is different: even if the OIG had determined that a CAS cost greater than zero was assigned to the period beginning January 1, 2002, it apparently would have deemed that cost to be unallowable. We base this conclusion on cell B112 of the "Notes" spreadsheet within the Excel workbook provided by the OIG, which includes the following notation:

> Nationwide made approximately 117,000,000 in contributions for the 2002 plan year. We have not included these in our CASCOST calculations since the entire amount was contributed after the 6/30/2002 segment closing date. This results in an unallowable [sic] unfunded as of 6/30/2002 that appears on the "2003" sheet in Exhibit B.2.

The OIG has provided no support for its contention that a segment closing affects the funding deadline for pension costs for the period in which the closing occurs. Contrary to this position, any pension costs assigned to 2002 did not have to be funded by the segment closing date, but rather could have been funded at any time prior to the tax filing deadline for the 2002 plan year. See Original CAS 412.50(c)(4); see also New CAS 412.50(d)(4).

Moreover, although the OIG indicates that there were zero contributions for 2002 (see Appendix to Cost Report at 9), under the OIG's treatment of prepayment credits (discussed below in more detail), any 2002 pension cost for the Medicare segment would presumably have been funded by the application of prepayment credits that existed as of January 1, 2002.

IV. Participant Transfers and Benefit Payments

The OIG claims that "Nationwide understated benefit payments by $546,231" and that "Nationwide overstated transfers out of the Medicare segment by $3,287,665." Segmentation Report at 6. As discussed below, these claims are wrong.

When Medicare participants retired, Nationwide transferred to the Other (i.e., non-Medicare) segment the sum of (1) assets equal to the actuarial liabilities for the newly retired participants at the end of the year in which they retired, plus (2) the amount of benefit payments paid to the retirees during the year of retirement; in this manner, Nationwide charged all benefit payments to the Other segment. OIG claims that Nationwide's approach is "incorrect[]" and substitutes a different methodology even though, for the periods prior to 1996, both approaches reach the same result.[7]

Moreover, the total Plan benefit payment amounts used by OIG in its analysis for 1996-2001 differ from those in Nationwide's Submission.[8] Nationwide based its calculations on the

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[7] For 1996 and later, the OIG reached results different from Nationwide's because the OIG assumes, with no justification, that New CAS 413 applies. This issue is discussed above.

[8] For example, the Submission reported total Plan benefit payments for 1996 of $68,158,379 (see Submission at S29, cell J114), but the Segmentation Report lists those benefit payments as $68,143,108 (see Appendix A of the Segmentation Report at 3).

audited Form 5500 information (see Submission at Tab A96), whereas we understand that the OIG used information from Nationwide's actuarial reports.[9] The OIG's use of actuarial reports as opposed to audited Form 5500s is puzzling, particularly given that the OIG relied on Form 5500 information for contribution amounts and dates of deposit. See Appendix to the Cost Report at 9 n.1.

V. 1995 Cost Claimed

The OIG contends that the fiscal 1995 cost claimed by Nationwide was $1,644,471. Cost Report at 3. In fact, however, the amount of cost Nationwide claimed for fiscal 1995 was $1,644,*417*. See Submission at S13, cell E122. The OIG apparently transposed the digits in question and carried the results of this error throughout its analysis.

VI. Federal Fiscal Year 1987-1988 Costs

Section XVI.C of Appendix B to the 1987 Contract required Nationwide to calculate pension costs in accordance with Section XVI.B "[b]eginning with the pension plan year starting in fiscal 1988." Thus, the 1987 Contract governed the calculation of Nationwide's pension costs for periods on and after March 1, 1988. Moreover, Section XVI.A provides:

> If the contractor complies with or makes a good faith effort to comply with the provisions of this Item XVI, neither the Secretary nor the contractor shall seek to adjust the pension costs allocated to prior Medicare contracts/agreements, which were entered into by the Secretary and the contractor, on the ground that the pension costs for a segment were not separately calculated, as required by CAS 413.40(c).

Notwithstanding this provision, the OIG seeks – with no explanation – to disallow all of Nationwide's pension costs from October 1, 1986 through February 29, 1988 (that is, the portion of its Federal fiscal year ("FFY") 1987-1988 costs prior to March 1, 1988). To illustrate, page 3 of the Cost Report compares (1) the costs Nationwide submitted on its FACPs for FFYs 1987 through 2002 to (2) the costs OIG determined for the same period, and asserts that the difference

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9 The various benefit payments reported for 1996 in Section III of the January 1, 1997 actuarial report do not add to the $68,143,108 reported in the Segmentation Report, although they are close. The difference appears to be related to the accrued benefit payments at the beginning of 1996 that the OIG mistakenly added instead of subtracted.

of $1,456,481 means that "Nationwide claimed $1,456,481 of unallowable Medicare pension costs for FYs 1987-2002."

The OIG claims that the allegedly unallowable amount of $1,456,481 includes $468,953 of costs for FFY 1987 and $291,020 of costs for FFY 1988, which total $759,973. The portion of these costs associated with the period October 1, 1986 through February 29, 1988 is shown in the following table:[10]

TABLE 1

Month	FACP Costs for Month
October 1986	0
November 1986	138,702
December 1986	(485,457)
January 1987	344,558
February 1987	104,700
March 1987	52,350
April 1987	52,350
May 1987	52,350
June 1987	52,350
July 1987	52,350
August 1987	52,350
September 1987	52,350
October 1987	52,350
November 1987	52,350
December 1987	(41,115)
January 1988	44,575
February 1988	44,575
	621,688

Because the OIG did not explain why it disallowed these pension costs, Nationwide is unable to provide a comprehensive response at this time. Informal discussions between Nationwide's consulting actuaries and the CMS Office of the Actuary suggest that OIG's view is based on an interpretation of Section XVI.A of Appendix B in which costs for the period from October 1, 1986 through February 29, 1988 must be determined in accordance with CAS 412 and 413. In addition, because Nationwide maintained segment accounting within its historical actuarial reports, the CMS Office of the Actuary apparently believes that segmented methodology must be applied to determine CAS costs for October 1, 1986 to February 29, 1988. Although it is Nationwide's view that the proper reading of Section XVI.A is that the OIG should not question

[10] These amounts are reported on pages S9 to S10 of the Submission.

pension costs for this period on account of Nationwide's "good faith effort to comply," even if the OIG's interpretation of that Section is correct, its conclusions are nevertheless wrong, as shown below:

- The March 1, 1986 actuarial report indicates that the Plan was not fully funded as of that date.[11] Section X of the report lists contribution ranges for the participating companies, and reports the following amounts for the Medicare segment (known as Company 31):

Maximum	$767,280
Minimum	440,508
15-Year Contribution	717,187

  On this basis, there is no reason to conclude that the pension cost assigned to the plan year beginning March 1, 1986 for the Medicare segment would be zero.

- The 1986 Form 5500 and Schedule B each report contributions of $19,801,488, and Section IX of the March 1, 1987 actuarial report lists contributions for March 1, 1986 to February 28, 1987 for "Company Number 31" to be $645,201. The preceding bullet established the presence of a non-zero assignable CAS pension cost for the Medicare segment for the year beginning March 1, 1986, and this bullet establishes that Nationwide's funding was well in excess of the assignable pension cost for the Medicare segment.[12] Accordingly, there is no reason to conclude that the amount of the pension cost assigned to the March 1, 1986 to February 28, 1987 period would not be allowable.

- Nationwide adopted Statement of Financial Accounting Standards No. 87 ("FAS 87") in 1987. See March 1, 1987 Actuarial Report, Section XIII. Accordingly, pursuant to Original CAS 412.50(b)(2)(i), the CAS pension cost for 1987 should be determined under an immediate gain method rather than the frozen initial liability approach that was used before 1987; however, due to the brief time period in which to prepare a response, it was not possible to make the requisite calculations. Accordingly, the points in the bullets below are based on information that is readily available.

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11 The March 1, 1986 actuarial report states: "The Full Funding Limitation was determined to be in excess of $66,490,264, well above the maximum contribution and, therefore, not applicable." Section I, at 3.

12 Because Nationwide did not allocate any indirect pension costs to the Medicare program, funding for CAS purposes can be made first to the Medicare segment and then to other segments. We understand that this treatment is consistent with the position OIG has taken with other Medicare contractors.

- The March 1, 1987 valuation report indicates that the Plan was not fully funded as of that date.[13] Section XI of the report lists contribution ranges for the participating companies, and reports the following amounts for the Medicare segment (Company 31):

Maximum	$791,652
Minimum	537,110
FAS 87 net periodic pension cost	534,735

  On this basis, there is no reason to conclude that the pension cost assigned to the plan year beginning March 1, 1987 would be zero.

- The 1987 Form 5500 and Schedule B each report contributions for the year of $31,419,137, and Section IX of the March 1, 1988 actuarial report lists contributions for March 1, 1987 to February 29, 1988 for "Company Number 31" to be $798,011. The preceding bullet established a non-zero CAS pension cost for the Medicare segment for the year beginning March 1, 1987, and this bullet establishes that Nationwide's funding would have been well in excess of the assignable pension cost for the Medicare segment.[14] Accordingly, there is no reason to conclude that the amount of the pension cost assigned to the period March 1, 1987 to February 29, 1988 would not be allowable.

- Nationwide's contemporaneous actuarial reports show the amount of assets for the Medicare segment as of March 1, 1986 to be $8,389,985. See Section VIII of the March 1, 1986 actuarial report. Nationwide used those reports to determine the pension costs for the Medicare segment as described in those reports (and as discussed in the preceding bullets). However, the OIG contends that the proper asset value for the Medicare segment on March 1, 1986 is $8,110,959. See Segmentation Report, Appendix A, at 1. Thus, if CAS pension costs were to be recomputed as of March 1, 1986 and March 1, 1987, which appears to be the OIG's position, those costs would be based on a smaller asset base and therefore would be higher than the amounts shown in Nationwide's historical actuarial reports.

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[13] The March 1, 1987 actuarial report states: "The Full Funding Limitation (IRC Section 404) was determined to be $35,045,142 which is greater than the maximum contribution and, therefore, not applicable." Section I, at 3.

[14] As stated earlier, Nationwide did not allocate any indirect pension costs to the Medicare program so that funding for CAS purposes would be deemed to be made first to the Medicare segment.

Although the OIG disallowed all of Nationwide's costs for FFYs 1987 and 1988 (see Cost Report at 3), it nonetheless agreed with the amount of contributions Nationwide reported for those same years (see Segmentation Report, Appendix C). If the OIG believed that the costs for the Medicare segment were zero for FFYs 1987 and 1988, those contributions should be treated as prepayments and should not be considered assets of the Medicare segment for CAS purposes. But the OIG has included these amounts as Medicare segment assets and claims that it is entitled to recover these amounts (as adjusted for investment return to the segment closing date) in connection with the segment closing. This treatment is patently unfair – there is no basis for the Government to attempt to recover costs from a contractor that it has deemed to be unallowable and has therefore refused to reimburse.

In summary, (1) there is no basis for the OIG's disallowance of Nationwide's pension costs for the October 1, 1986 to February 29, 1988 period; (2) any appropriate adjustments to be made to Nationwide's FACPs for that period would be upwards and not downwards; and (3) there is no basis for OIG's attempt to recover costs that it claims are unallowable.

VII. Application of Prepayment Credits

Because actuarial valuations are typically made as of the first day of a plan year but contributions are generally made at one or more later dates, pension costs are typically adjusted with interest at the valuation rate from the valuation date to the date(s) of payment. In this manner, the pension fund is compensated for the investment income that would presumably have been earned if the funding had occurred on the valuation date. The original CAS Board specifically sanctioned this approach: "Several commentators stated that they compute pension cost at the beginning of a cost accounting period and add interest at the valuation rate to the normal cost to the date of funding. . . . The Standard being promulgated does not prohibit this practice . . . ." 40 Fed. Reg. 43,873, 43,876 (Sept. 24, 1975) (Prefatory Comment 10 to Original CAS 412).

In practice, contractors typically compute CAS pension costs based on assumed funding dates. For at least the last 20 or so years, the Government was aware of and incorporated this practice into its standard pension review policies:

> The amount of interest added ***in the actuarial valuation*** to the amount of pension cost due as of the valuation date should be reviewed. The amount of add on interest included in charges to Government contracts should not exceed (8.5 divided by 12) X (the actuarial interest rate) X (the contribution due as of the beginning of the valuation period).

Defense Contract Administration Services Manual for Conducting Contractor Insurance/Pension Reviews at 32 (June 1987) (emphasis added). The factor of "8.5 divided by 12" is equivalent to the funding schedule set forth at FAR § 31.205-6(j)(2)(iii) (2008), which contemplates that pension costs will be funded 30 days after the end of each quarter.

In practice, the interest calculations are documented ***in the actuarial valuation report***. In other words, the interest adjustment is made in advance on the basis of ***assumed contribution dates*** rather than retrospectively based upon ***actual funding dates***.

However, the OIG asserts that:

> Nationwide overstated contributions and prepayment credits by \$1,713,391 because of . . . Nationwide's use of an imputed interest cost in its current-year contributions . . . rather than on the interest incurred based on the actual timing of funding deposits, as required by the FAR.
>
> In compliance with CAS 412.50(a)(4) and FAR 31.201-1(a), we applied prepayment credits first to current-year assignable pension costs and then updated any remaining credits with interest to the next measurement (valuation) date because the credits are available at the beginning of the year . . . .

Segmentation Report at 5-6. Thus, the OIG contends that, when prepayment credits are present, CAS pension costs must be calculated based on presumed funding on the first day of the plan year. To illustrate, suppose the pension cost for a year is measured to be \$10,000 as of the first day of the year, that pension costs are presumed to be funded in accordance with the FAR schedule, and that the valuation interest rate is 6%. In the absence of prepayment credits, the parties would agree that the CAS pension cost for the year, adjusted for interest, would be determined as follows:[15]

$$\begin{aligned}\text{CAS Pension Cost} \quad &= \$10{,}000 \times \left(1 + \frac{8.5}{12} \times 6\%\right) \\ &= \$10{,}425\end{aligned}$$

Nationwide made the CAS cost calculations in its Submission in a manner consistent with the \$10,425 for all years. In contrast, the OIG contends that the CAS cost would be limited to \$10,000 if prepayment credits of at least \$10,000 were present at the beginning of the Plan year. For the reasons set forth below, the OIG's position is incorrect.

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[15] This approach is consistent with both Nationwide's approach in its Submission as well as calculations made by the CMS actuaries when prepayments are not present. <u>See</u>, <u>e.g.</u>, Appendix to Cost Report at 2 (in the "Allowable Interest" calculation for 1989 of \$34,170, the amount is calculated as $\$603{,}006 \times \left(\frac{8.5}{12} \times 8.00\%\right)$).

- ***The prepayments belong to Nationwide***. It is well accepted among actuarial professionals that prepayment credits belong to contractors. It simply does not make sense that the Government can reap a benefit (e.g., a savings of $425 in the preceding illustration) from an asset in which it has no ownership interest.

- ***Nationwide's approach is CAS compliant***. Despite the assertion in the language quoted above from page 6 of the Segmentation Report, New CAS 412.50(a)(4)[16] does not support OIG's contention that prepayment credits must be applied on the first day of a plan year. In fact, that provision states that "prepayment credits shall be adjusted for interest at the valuation rate of interest until applied towards pension cost in a future accounting period," which is precisely what Nationwide did. Indeed, as demonstrated in the following bullet, OIG's position is inconsistent with New CAS 412, which clarifies that the decision to apply prepayment credits is made by Nationwide, not the OIG.

- ***OIG's approach violates New CAS 412***. The OIG's position is in direct conflict with New CAS 412.60(c)(5). As background, the example at New CAS 412.60(c)(5) contemplates a situation where the CAS 412 assignable pension cost is $1.5 million, the contribution amount is $1.0 million, and prepayment credits at the beginning of the period are $700,000. Under the theory articulated in the Segmentation Report, the hypothetical contractor described at New CAS 412.60(c)(5) would have been required to apply the full $700,000 of prepayments at the beginning of the year towards the $1.5 million cost for the year. However, New CAS 412.60(c)(5) provides that the contractor "can apply $500,000 of the accumulated value of prepayment credits towards the pension cost computed for the period." Thus, the contractor can choose to apply its prepayment credits before or after it applies its contributions, at its discretion. This illustration fatally undermines the OIG's assertion that prepayment credits are automatically applied on the first day of a plan year. New CAS 412.60(c)(13) and New CAS 412.60(d)(4) further reinforce that the contractor retains the discretion as to when prepayment credits are applied and the amount so applied.

- ***FAR does not support OIG's position***. The OIG also asserts (see, e.g., Segmentation Report at 5) that FAR 31.201-1(a) supports its position. FAR 31.201-1(a) states:

  > The total cost, including standard costs properly adjusted for applicable variances, of a contract is the sum of the direct and indirect costs allocable to the contract, incurred

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16 As discussed above, New CAS 412 and 413 never applied to Nationwide's 1987 Contract. Nonetheless, simply for purposes of argument, our response is here based on the provisions of New CAS 412 cited by the OIG.

> or to be incurred, plus any allocable cost of money pursuant to 31.205-10, less any allocable credits. In ascertaining what constitutes a cost, any generally accepted method of determining or estimating costs that is equitable and is consistently applied may be used.

The OIG does not explain how this very general provision concerning the total cost of a contract supports its position concerning the very specific issue of prepayment credits or any of the other specific issues in the Segmentation Report. In any event, this broad FAR provision offers no support for the OIG's position that prepayment credits must be applied on the first day of a plan year versus Nationwide's position that the contractor retains full discretion as to the application of prepayment credits.

VIII. Asset Valuation Method

Nationwide's Submission states that "[t]he 1989 change in the ERISA asset valuation method from account value to market value was not adopted for CAS purposes." Submission at II-1. Nevertheless, OIG's calculation of costs presumed that the asset valuation method for purposes of CAS 412 and 413 was revised to remain consistent with ERISA.

Contractors, and not the government, are entitled to select their cost accounting practices. Accordingly, the OIG's analysis should be revised to reflect the asset valuation methodology chosen by Nationwide for CAS purposes as reported in the Submission. If the OIG means to suggest that Nationwide's Submission was not compliant, that suggestion is wrong.

IX. Allocation of Return

Under Original CAS, investment return is allocated to segments based on CAS 413.50(c)(7), which states: "Fund income and expenses shall be allocated to the segment in the same proportion that the assets allocated to the segment bears to the total fund assets as of the beginning of the period for which fund income and expenses are being allocated."

Nationwide prepared the Submission on this basis. The OIG, without providing any rationale, used a methodology that does not comply with Original CAS 413.50(c)(7) and that provides CMS with an unwarranted windfall. OIG's methodology relies on a misreading of the phrase "assets as of the beginning of the period." A plain reading of the regulation means that investment return should be allocated in proportion to assets at the start of each year without regard to transactions that apply to the current plan year. Yet the OIG defines beginning-of-period assets to include CAS costs for the upcoming year that it contends must be "automatically funded" through the application of prepayment credits.[17] The illustration in Table 2 below helps to explain the flaws in the OIG's position:

TABLE 2

	Other Segment				
	Segment Assets	Prepayment Credit	Total	Medicare Segment	Total Plan
1. Beginning of year	20,000	1,000	21,000	12,000	33,000
2. Prepayment transfer to cover Medicare segment CAS cost		(1,000)	(1,000)	1,000	0
3. OIG "beginning of year"	20,000	0	20,000	13,000	33,000
4. Actual return for year					3,300
5. Allocation of actual return for year					
a. OIG approach (in proportion to line 3.)			2,000	1,300	3,300
b. Nationwide position (in proportion to line 1.)			2,100	1,200	3,300
c. Difference, a. - b.			(100)	100	0

The example in Table 2 presumes that the CAS cost for the Other segment is zero, the CAS cost for the Medicare segment is $1,000, and prepayment credits are $1,000. Line 3 of Table 2 equals the assets as of the beginning of the year adjusted for the transfer of $1,000 of prepayment credits from the Other segment to the Medicare segment to fund that segment's CAS cost for the year of $1,000.[18] If the total asset return for the plan is $3,300, the parties disagree

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[17] This discussion adopts, for the purposes of argument, the OIG's mechanical approach to applying prepayment credits. As discussed above, that approach is wrong.

[18] The OIG presumes that prepayment credits are maintained within the Other segment. In contrast, Nationwide's Submission assumed that prepayment credits are not associated with either segment but rather represent an asset of the overall plan. See, e.g., Submission at S27-S31.

As with other issues discussed in this response, OIG has not explained the basis for its conclusion that the approach taken by Nationwide in the Submission is noncompliant. Nationwide's approach provides greater transparency when a prepayment credit is used to fund a CAS cost of the Other segment. In addition, by retaining prepayment credits within a segment, the OIG's approach means that any actuarial gains and losses arising from differences between actual rates of investment return and the valuation rate of interest (which is credited on prepayment credits) will be recognized solely within the Other segment. Under the OIG's approach, two otherwise identical segments would have different costs. Accordingly, the OIG's approach does not comply with the segment accounting requirements of CAS 413.

as to whether the $3,300 return should be allocated in proportion to line 1 (Nationwide's position) or in proportion to line 3 (the OIG's position)?

As shown in Table 2, the OIG method increases the investment return allocation to the Medicare segment in this illustration by 8.3% (that is, $100 divided by $1,200). Because prepayment credits are transferred from the Other segment to the Medicare segment only under the OIG approach, and because any differences in the allocation of investment returns will compound over many years, the OIG approach can result in significant reductions in pension costs allocated to ongoing Medicare contracts and in larger asset values of Medicare segments at contract termination, thereby increasing the amount of surplus available for recovery by CMS under CAS 413.50(c)(12).

This potential increased CMS recovery under the OIG approach is inconsistent with the governing regulation. Original CAS 413.50(c)(7) refers to assets "as of the beginning of the period," but the OIG interprets this to mean "assets as of the beginning of the period, but including any prepayments that have been identified and transferred to the segment once pension costs have been calculated for the year." Although OIG apparently contends that the prepayments are theoretically transferred "as of the beginning of the period," the transfers of prepayments (assuming that the automatic transfers themselves are valid) necessarily occur later. To illustrate, the Medicare segment assets of $10,000 in line 1 of Table 2 must be used to calculate the $1,000 in CAS pension cost for the year. Thus, the $1,000 cost cannot be known – even in theory – until after the $10,000 Medicare segment asset value is available.

For the reasons explained above, the OIG's position on the meaning of "beginning of the period" under CAS 413.50(c)(7) is wrong. Yet even assuming for the sake of argument that the OIG methodology does satisfy CAS 413, the OIG has not shown that the methodology used by Nationwide is noncompliant.

X. OIG Audit Approach

The OIG focused its findings on the CAS 412 and 413 pension cost calculations made by the CMS Office of the Actuary rather than Nationwide's calculations in the Submission. For example, the OIG states, on page 2 of the Cost Report, that "the CMS Office of the Actuary calculated the allocable CAS pension costs . . . ." We understand that the CMS actuaries used a portion of the data contained in the Submission to calculate Nationwide's CAS pension costs, compared the results of their calculations with the amounts submitted on Nationwide's Final Administrative Cost Proposals ("FACPs"), and deemed any resulting differences to be unallowable. See Cost Report at 3.[19] That approach is improper; the fact that a variance exists

[19] The "Per Audit" column on page 3 of the Cost Report apparently refers to calculations of CAS pension costs made by the CMS Office of the Actuary, and the "Per Nationwide" column represents amounts that were reported on Nationwide's FACPs as having been charged to CMS over the years. The amounts of CAS pension costs included in the Submission were apparently
(cont'd)

between calculations performed by a CMS actuary and those performed by a Nationwide actuary does not mean that the amount of the variance is unallowable. It is well established within the actuarial profession that, although calculations made by two actuaries may yield different results, it does not necessarily follow that one of the two actuaries has erred. Rather, variances may be attributable to the use of different, but nonetheless permissible, actuarial techniques. Significantly, the OIG has not even tried to explain why its recalculation is proper and must be used in place of Nationwide's calculations; nor has the OIG tried to explain why Nationwide's calculations are improper.

We understand that the OIG commissioned the CMS actuaries' work product. In other words, the OIG was the client of the CMS Office of the Actuary for purposes of making those pension cost calculations. Thus, this process does not appear to comply with the "independence" requirements imposed by generally accepted Government auditing standards.[20] Specifically, Section 3.04 of the Government Audit Standards states:

> Auditors and audit organizations have a responsibility to maintain independence so that opinions, conclusions, judgments, and recommendations will be impartial and will be viewed as impartial by knowledgeable third parties. Auditors should avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditors are not able to maintain independence and, thus, are not capable of exercising objective and impartial judgment on all issues associated with conducting and reporting on the work.

In this case, the OIG is charged with auditing pension costs submitted by Nationwide to CMS. But OIG then engaged CMS – ***a party to the Medicare contracts*** – to make an "independent" calculation of Nationwide's pension costs, and it then uncritically accepted as correct the results of the CMS calculations. CMS has an obvious financial interest in maximizing the extent to which pension costs can be deemed unallowable and, as explained above, this is precisely what CMS has done.

Conclusion

(... cont'd)

not factored into the OIG's determination of the "$1,456,481 of unallowable Medicare pension costs" discussed on that page.

[20] Government auditing standards are published by the Government Accountability Office. See http://www.gao.gov/govaud/yb/2003/html/TOC.html.

Nationwide appreciates the opportunity to submit comments on the draft audit reports, and we look forward to maintaining a dialogue with your office and attempting to resolve, through informal means, all open issues.

Thank you again for your continuing cooperation. Please let me know if you have any questions or comments.

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