SEP 30 2008

TO: Kerry Weems
Acting Administrator
Centers for Medicare & Medicaid Services

FROM: Joseph E. Vengrin
Deputy Inspector General for Audit Services

SUBJECT: 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)

Attached is an advance copy of our final report on the qualified pension plan at Nationwide Mutual Insurance Company (Nationwide), a terminated Medicare contractor. We will issue this report to Nationwide within 5 business days.

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

- identifying the Medicare segment asset base (initial allocation) as of March 1, 1986;
- updating Medicare segment assets from March 1, 1986, to June 30, 2002; and
- determining Medicare's share of the Medicare segment excess pension assets as of the termination of Nationwide's Medicare contracts.

Nationwide did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements. Specifically, Nationwide did not correctly identify the initial allocation of pension plan assets to the Medicare segment as of March 1, 1986, and did not comply with the Medicare contracts' pension segmentation requirements for updating Medicare segment assets from March 1, 1986, to June 30, 2002. As a result, Nationwide understated the Medicare segment assets by $1,990,365.

In addition, Nationwide did not comply with the provisions of its Medicare contracts or the Cost Accounting Standards when determining Medicare's share of the Medicare segment excess pension assets as of the termination of the Medicare contracts. We identified $14,891,163 as Medicare's share; however, Nationwide identified $7,378,044 as Medicare's share. Therefore, Nationwide understated Medicare's share by $7,513,119.

We recommend that Nationwide:

- increase Medicare segment pension assets as of June 30, 2002, by $1,990,365;

- increase Medicare's share of the excess Medicare segment pension assets as of June 30, 2002, by $7,513,119; and

- refund to the Federal Government $14,891,163, which we calculated to be Medicare's share of the Medicare segment excess pension assets as of the termination of the Medicare contracts.

In written comments on our draft report, Nationwide did not address our recommendations. Nationwide disagreed with our findings, calculations, valuation methods, and the applicability of some of the criteria that we used. After reviewing Nationwide's comments, we made a minor revision to our calculations and the related recommendations. Our findings and recommendations, as revised, are valid.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through e-mail at George.Reeb@oig.hhs.gov or Patrick J. Cogley, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591 or through e-mail at Patrick.Cogley@oig.hhs.gov. Please refer to report number A-07-07-00239.

Attachment

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

OCT - 2 2008

Report Number: A-07-07-00239

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 the Qualified Pension Plan at Nationwide Mutual Insurance Company, a Terminated Medicare Contractor, for the Period March 1, 1986, to June 30, 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 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-07-07-00239 in all correspondence.

Sincerely,

Patrick J. Cogley

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 THE QUALIFIED PENSION PLAN AT NATIONWIDE MUTUAL INSURANCE COMPANY, A TERMINATED MEDICARE CONTRACTOR, FOR THE PERIOD MARCH 1, 1986, TO JUNE 30, 2002

Daniel R. Levinson
Inspector General

October 2008
A-07-07-00239

Office of Inspector General

http://oig.hhs.gov

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

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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) from July 1, 1966, until the contractual relationship was terminated on June 30, 2002. The effective closing date for the Medicare segment was June 30, 2002.

Pension Plan

Nationwide sponsors a defined-benefit pension plan, which is a deferred compensation plan in which an employer makes actuarially determined contributions to fund an employee's retirement benefit as defined by the plan's terms.

Since its inception, Medicare has paid a portion of contractors' contributions to their pension plans. These contributions are allowable Medicare costs subject to the criteria set forth in the Medicare contracts, Federal Procurement Regulations, Federal Acquisition Regulation, and Cost Accounting Standards (CAS). Furthermore, the Medicare contracts specifically prohibit any profit (gain) from Medicare activities. Therefore, contractors must credit to the Medicare program those pension gains (excess pension assets) that occur when a Medicare segment terminates.

Pension Segmentation

Beginning with fiscal year 1988, CMS incorporated segmentation requirements into the Medicare contracts. The Medicare contracts define a segment and specify the methodology for the identification and initial allocation of pension assets to the segment. Additionally, the contracts require Medicare segment assets to be updated for each year after the initial allocation in accordance with CAS 412 and 413.

Upon the termination of its Medicare contracts, Nationwide identified Medicare's share of the Medicare segment excess pension assets to be $7,378,044. However, Nationwide has not refunded any of this amount, opting to wait until the results of our audit are finalized.

OBJECTIVE

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

- identifying the Medicare segment asset base (initial allocation) as of March 1, 1986;
- updating Medicare segment assets from March 1, 1986, to June 30, 2002; and
- determining Medicare's share of the Medicare segment excess pension assets as of the termination of Nationwide's Medicare contracts.

SUMMARY OF FINDINGS

Nationwide did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements. Specifically, Nationwide did not correctly identify the initial allocation of pension plan assets to the Medicare segment as of March 1, 1986, and did not comply with the Medicare contracts' pension segmentation requirements for updating Medicare segment assets from March 1, 1986, to June 30, 2002. As a result, Nationwide understated the Medicare segment assets by $1,990,365.

In addition, Nationwide did not comply with the provisions of its Medicare contracts or the CAS when determining Medicare's share of the Medicare segment excess pension assets as of the termination of the Medicare contracts. We identified $14,891,163 as Medicare's share; however, Nationwide identified $7,378,044 as Medicare's share. Therefore, Nationwide understated Medicare's share by $7,513,119.

RECOMMENDATIONS

We recommend that Nationwide:

- increase Medicare segment pension assets as of June 30, 2002, by $1,990,365;

- increase Medicare's share of the excess Medicare segment pension assets as of June 30, 2002, by $7,513,119; and

- refund to the Federal Government $14,891,163, which we calculated to be Medicare's share of the Medicare segment excess pension assets as of the termination of the Medicare contracts.

AUDITEE COMMENTS

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

OFFICE OF INSPECTOR GENERAL RESPONSE

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

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A – MARKET VALUE OF PENSION ASSETS FOR THE PERIOD MARCH 1, 1986, TO JUNE 30, 2002

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D – COMPARISON OF NET ASSET TRANSFERS

E – CALCULATION OF AGGREGATE MEDICARE PERCENTAGE

F – AUDITEE COMMENTS

Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
ERISA	Employee Retirement Income Security Act of 1974
FAR	Federal Acquisition Regulation
FPR	Federal Procurement Regulations
FY	fiscal year
GAGAS	generally accepted government auditing standards
Nationwide	Nationwide Mutual Insurance Company
WAV	weighted average value

INTRODUCTION

BACKGROUND

Nationwide Mutual Insurance Company (Nationwide) administered Medicare Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) from July 1, 1966, until the contractual relationship was terminated on June 30, 2002. The effective closing date for the Medicare segment was June 30, 2002.

Pension Plan

Nationwide sponsors a defined-benefit pension plan, which is a deferred compensation plan in which an employer makes actuarially determined contributions to fund an employee's benefit as defined by the plan's terms. Once an employee satisfies the plan's age and service requirements and retires, he or she is eligible to receive a monthly payment from the plan. The plan accumulates assets from employer contributions and net investment earnings to fund the actuarial liability for both earned and projected future benefits. To the extent that assets accumulate from better-than-expected investment earnings, the amount of required annual employer contributions decreases and may even be eliminated for some years.

Since its inception, Medicare has paid a portion of contractors' contributions to their pension plans. These contributions are allowable Medicare costs subject to the criteria set forth in the Medicare contracts, Federal Procurement Regulations (FPR), Federal Acquisition Regulation (FAR), and Cost Accounting Standards (CAS). Furthermore, the Medicare contracts specifically prohibit any profit (gain) from Medicare activities. Therefore, contractors must credit to the Medicare program those pension gains (excess pension assets) that occur when a Medicare segment terminates.

Federal Requirements

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

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

FAR Part 31 and its predecessor, FPR, address the allowability of pension costs and the recovery of gains, rebates, and other forms of credits for Federal contractors.

Pension Segmentation

CMS incorporated CAS 412 and 413 into the Medicare contracts effective October 1, 1980. Starting in fiscal year (FY) 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 CAS 412 and 413. In claiming costs, contractors must follow cost reimbursement principles contained in the FAR, CAS, and Medicare contracts.

Upon the termination of its Medicare contracts, Nationwide identified Medicare's share of the Medicare segment excess pension assets to be $7,378,044. However, Nationwide has not refunded any of this amount, opting to wait until the results of our audit are finalized.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

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

- identifying the Medicare segment asset base (initial allocation) as of March 1, 1986;
- updating Medicare segment assets from March 1, 1986, to June 30, 2002; and
- determining Medicare's share of the Medicare segment excess pension assets as of the termination of Nationwide's Medicare contracts.

Scope

We reviewed Nationwide's identification of its Medicare segment, computation of the initial assets allocated to the Medicare segment, and update of Medicare assets from March 1, 1986, to June 30, 2002 (the closing date for the Medicare segment). Nationwide did not maintain complete records of how it accounted for segment assets when computing pension costs charged to the Medicare contracts. However, prior to our review, Nationwide engaged an actuarial consulting firm to analyze and reconstruct its asset accounting. We referred to the reconstructed asset accounting and supporting data during our review.

Achieving our objectives did not require us to review Nationwide's overall internal control structure. However, we reviewed controls relating to the identification of the Medicare segment, the update of the segment's assets, and the determination of the final segment liabilities.

We performed fieldwork at Nationwide in Columbus, Ohio.

Methodology

To accomplish our objective:

- We reviewed the applicable portions of the FPR, FAR, CAS, and Medicare contracts.

- We reviewed the reconstructed data and analysis provided by Nationwide's actuarial consulting firm and the annual actuarial valuation reports prepared by Nationwide's internal actuarial department, 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 assets.

- We obtained the pension plan documents and Department of Labor/Internal Revenue Service Form 5500s used in calculating the Medicare segment assets.

- We interviewed Nationwide staff responsible for identifying the Medicare segment to determine whether the segment was properly identified in accordance with the Medicare contracts.

- We reviewed Nationwide's accounting records to verify the segment identification and benefit payments made to the Medicare segment.

- We provided the CMS Office of the Actuary with the actuarial information necessary for it to calculate the Medicare segment assets and the Medicare segment excess pension assets as of June 30, 2002.

- We reviewed the CMS actuaries' methodology and calculations.

We performed this review in conjunction with our audit of Nationwide's pension costs claimed for Medicare reimbursement (A-07-07-00240) and used the information obtained during that audit in this review.

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 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

Nationwide did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements. Specifically, Nationwide did not correctly identify the initial allocation of pension plan assets to the Medicare segment as of March 1, 1986, and did not comply with the Medicare contracts' pension segmentation requirements for updating Medicare segment assets from March 1, 1986, to June 30, 2002. As a result, Nationwide understated the Medicare segment assets by $1,990,365.

Appendix A presents details of the Medicare segment's pension assets from March 1, 1986, to June 30, 2002, as determined during our audit. Table 1 on the next page summarizes the audit adjustments required to update Medicare segment pension assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments			
	Per Audit	**Per Nationwide**	**Difference**
Initial allocation	$8,110,959	$8,106,641	$4,318
Update of pension assets:			
Contributions and prepayment credits	11,875,029	13,166,119	(1,291,090)
Benefit payments	(715,697)	(169,466)	(546,231)
Transfers	(15,424,261)	(18,711,926)	3,287,665
Earnings, net expenses	30,585,564	30,049,861	535,703
Understatement of Medicare segment			**$1,990,365**

In addition, Nationwide did not comply with the provisions of its Medicare contracts or the CAS when determining Medicare's share of the Medicare segment excess pension assets as of the termination of the Medicare contracts. We identified $14,891,163 as Medicare's share; however, Nationwide identified $7,378,044 as Medicare's share.[1] Therefore, Nationwide understated Medicare's share by $7,513,119.

MEDICARE SEGMENT ASSET BASE (INITIAL ALLOCATION)

Federal Requirements

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

Understated Medicare Segment Asset Base as of March 1, 1986

Nationwide calculated an asset fraction of 1.502 percent as of March 1, 1981, and used that figure to calculate Medicare segment assets totaling $8,106,641 as of March 1, 1986. Nationwide used the 1981 actuarial valuation report and actuarial valuation data printouts to obtain the accrued actuarial liabilities for the total company and for the Medicare segment. Nationwide then used these amounts to calculate its asset fraction. However, Nationwide did not adjust the accrued actuarial liabilities for errors on the data printout. As a result, the accrued actuarial liability amounts that Nationwide used to calculate the asset fraction did not reconcile to the 1981 actuarial valuation report. We calculated the asset fraction to be 1.5028 percent, which was 0.0008 percent higher than Nationwide's value.

We applied this revised asset fraction to the audited total company pension assets as of March 1, 1986, and calculated Nationwide's Medicare segment asset base to be $8,110,959. Our calculations increased the Medicare segment assets by $4,318 ($8,110,959 less $8,106,641) as of

[1]As stated earlier, Nationwide has not refunded any of these excess assets.

March 1, 1986. Nationwide's initial allocation of Medicare segment assets was understated because Nationwide did not adjust its asset fraction as discussed above. Details of Nationwide's and our calculations of the initial asset allocation appear in Appendix B.

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. For plan years beginning on or before March 30, 1995, the CAS requires investment income and expenses to be allocated among segments in proportion to the beginning-of-year asset value. For plan years beginning after March 30, 1995, the CAS requires investment income and expenses to be allocated among segments based on the ratio of the segment's weighted average value (WAV) of assets to total company WAV of assets.

In addition, CAS 413.50(c)(8) requires an adjustment to be made for transfers (participants who enter or leave the segment) if the transfers materially affect the segment's ratio of pension plan assets to actuarial accrued liabilities. For plan years beginning after March 31, 1995, the CAS requires that the assets transferred equal the actuarial accrued liabilities as determined using the accrued benefit cost method.

Furthermore, CAS 412.50(a)(4) requires that contributions in excess of the pension cost assigned to the period be recognized as prepayment credits and accumulated at the assumed valuation interest rate until applied to future period costs. Prepayment credits that have not been applied to fund pension costs are excluded from the value of assets used to compute pension costs.

Finally, FAR 31.201-1(a) requires that "[t]he 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 or to be incurred . . . ."

Contributions and Prepayment Credits Overstated

Nationwide overstated contributions and prepayment credits by $1,291,090 because of differences in assignable pension costs, which resulted from Nationwide's use of an imputed interest cost in its current-year contributions. Nationwide based its computation of the contributions and prepayment credits on an assumed end-of-year funding schedule rather than on the interest incurred based on the actual timing of funding deposits, as required by the FAR. Using the actual timing of funding deposits changed the Medicare asset values, which resulted in differences in the assignable pension costs.

The audited contributions and prepayment credits are based on the assignable pension costs. 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. We then allocated contributions as needed to assigned pension costs as of the date of deposit.

Appendix C compares Nationwide's and our calculations of allocated pension contributions and prepayment credits.

Benefit Payments Understated

Nationwide understated benefit payments by $546,231 because it incorrectly included the benefit payments in the net transfer amounts. Benefit payments made during the year to Medicare segment participants should have been treated as benefit payments rather than asset transfers out of the Medicare segment, as required by CAS 413.50(c)(7).

Net Transfers Overstated

Nationwide overstated transfers out of the Medicare segment by $3,287,665. Nationwide made adjustments for transfers in its update of segment assets; however, it did not revalue transfers using the accrued benefit cost method for plan years after March 31, 1995, as required by the revised CAS. In addition, as mentioned earlier, Nationwide incorrectly included benefit payments in the transfer amount. Therefore, Nationwide overstated its Medicare segment assets by $3,287,665. Appendix D compares Nationwide's and our calculations of net asset transfers from the Medicare segment.

Earnings and Expenses Understated

Nationwide understated investment earnings, less administrative expenses, by $535,703 for the Medicare segment. Nationwide did not use the WAV of assets to allocate earnings for plan years after March 31, 1995, as required by CAS 413.50(c)(7). In addition, Nationwide's practice of adjusting contributions to the end of the year did not properly reflect the actual timing of contributions in the WAV of assets allocated to each segment. Nationwide's methodology credited each segment with investment return on current-year contributions at the valuation rate,[2] instead of crediting current contributions with their actual rate of return as required by the CAS. Because of this error, Nationwide's allocation basis differed from that required by the CAS and led to different allocation amounts. In our audited update, we allocated earnings and expenses based on the applicable CAS requirements.

MEDICARE SEGMENT EXCESS PENSION ASSETS

Federal Requirements

Medicare Contracts

The Medicare contracts specifically prohibit any profit (gain) from Medicare activities. Pension gains that occur when a segment closes (i.e., contract terminations) must be credited to the

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[2]The valuation rate is the assumed interest rate used in actuarial computations to calculate the expected long-term rate of return on plan assets.

Medicare program, as required by the FAR. In the event of a contract termination, the Medicare contracts require contractors to follow the abnormal forfeiture provision of the FPR and the segment closing provision of the CAS.

Federal Procurement Regulations

The Medicare contracts in force from 1966 to 1981 required that contractors comply with the abnormal forfeiture provisions in the event of a contract termination.

FPR 1-15.205-6(f)(3) states:

> (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.

Furthermore, FPR 1-15.201-5 states: "The applicable portion of any income, rebate, allowance, and other credit relating to any allowable cost, received by or accruing to the contractor, shall be credited to the Government either as a cost reduction or by cost refund, as appropriate."

The FPR kept the abnormal forfeiture adjustment for non-CAS-covered contracts when CAS 413 was incorporated into the FPR in 1980. All cost-based contracts awarded after the FAR was published in September 1983 were subject to the provisions of CAS 413-50(c)(12), and the abnormal forfeiture provision was determined to be unnecessary for future periods.

As amended in 1980, FPR 1-15.205-6(f)(3)(i)(B) reads:

> Under contracts not subject to Cost Accounting Standards, abnormal forfeitures due to significant reduction in the Contractor's level of employment that are foreseeable and which can be currently evaluated with reasonable accuracy by actuarial or other sound computation shall be reflected by an adjustment of the costs otherwise allowable. When abnormal forfeitures were not taken into account previously, appropriate credit shall be given to the Government in accordance with § 1-15.201-5 . . . .

Federal Acquisition Regulation

The FAR addresses dispositions of gains in situations such as segment closings. When excess or surplus assets revert to a contractor because of a termination of a pension plan, or when such assets are constructively received by the contractor for any reason, the contractor must make a refund or give credit to the Government for its equitable share (FAR 31.205-6(j)(4)).

Cost Accounting Standards

During 1980, CMS renegotiated the Medicare contracts and expressly incorporated CAS 412 and 413 into the contracts beginning October 1, 1980.

Contract terminations and segment closings are addressed by CAS 413.50(c)(12), which 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 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.

The methodology for determining the Federal Government's share of the excess pension assets is addressed by CAS 413.50(c)(12)(vi), which 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 Assets as of June 30, 2002

Nationwide identified $12,122,977 in excess Medicare segment pension assets as of June 30, 2002. However, we calculated the excess pension assets to be $14,904,577 as of that date. Therefore, Nationwide understated the excess pension assets by $2,781,600. The understatement occurred because Nationwide did not comply with the CAS in updating the Medicare segment pension assets to June 30, 2002, as previously discussed. In addition, Nationwide did not comply with CAS 413.50(c)(12) because it did not prorate a pension plan improvement made within 60 months of the segment closing and did not use the accrued benefit cost method to value the accrued liabilities for the active participants who remained with the company. Table 2 summarizes, for each of these causes, the differences between Nationwide's and our calculations.

Table 2: Summary of Adjustments to Excess Medicare Segment Pension Assets

	Per Audit	Per Nationwide	Difference
Medicare segment assets as of June 30, 2002	$34,431,594	$32,441,229	$1,990,365
Adjustment for plan improvement	247,950	0	247,950
Accrued liabilities of active participants	(651,185)	(1,194,470)	543,285
Understatement			**$2,781,600**

Medicare's Share of Excess Pension Assets as of June 30, 2002

Nationwide did not comply with the provisions of its Medicare contracts in determining Medicare's share of the Medicare segment excess pension assets as of June 30, 2002. Nationwide computed $7,378,044 as Medicare's share; however, we determined that Medicare's share was $14,891,163. Therefore, Nationwide understated Medicare's share by $7,513,119.

For the years prior to October 1, 1980, the Medicare contracts incorporated the FPR, which included the provision for crediting the actuarial gain from abnormal forfeitures, i.e., "significant reduction in the Contractor's level of employment," cited above. For the year beginning October 1, 1980, and for succeeding years, the Medicare contracts incorporated CAS 412 and 413 and required that those Federal requirements, including the calculation of the segment closing adjustment, be followed.

At the end of the Medicare contracts, Nationwide closed its Medicare Division with a mass termination of the employees. Thus, Nationwide's termination of its Medicare contracts met the criteria of both an abnormal forfeiture and a segment closing. Therefore, Nationwide should have calculated the aggregate Medicare percentage using the information from 1966 to June 30, 2002, the date that the contractual relationship was terminated, in both the numerator and the denominator of the fraction. However, Nationwide calculated its aggregate Medicare percentage by dividing the Medicare segment contributions for plan years 1988 through 2002 (the numerator) by the Medicare segment contributions for plan years 1966 through 2002 (the denominator). This methodology did not comply with the criteria for an abnormal forfeiture or a segment closing.

We calculated the Medicare segment's aggregate Medicare percentage in compliance with both the abnormal forfeiture and the segment closing criteria and applied that percentage to the Medicare segment's excess pension assets to determine Medicare's share of the excess assets. Appendix E shows our calculation of the Medicare segment's aggregate Medicare percentage; Table 3 shows our calculation of Medicare's share of the excess assets.

Table 3: Calculation of Medicare's Share of the Excess Assets

	Excess Medicare Segment Assets (A)	Aggregate Medicare Percentage (B)	Excess Assets Attributable to Medicare (AxB)
Per audit	$14,904,577	99.91%	$14,891,163
Per Nationwide	12,122,977	60.86%	7,378,044
Difference			**$7,513,119**

RECOMMENDATIONS

We recommend that Nationwide:

- increase Medicare segment pension assets as of June 30, 2002, by $1,990,365;
- increase Medicare's share of the excess Medicare segment pension assets as of June 30, 2002, by $7,513,119; and
- refund to the Federal Government $14,891,163, which we calculated to be Medicare's share of the Medicare segment excess pension assets as of the termination of the Medicare contracts.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, Nationwide did not address our recommendations. Nationwide disagreed with our findings and identified 10 areas of dispute pertaining to this report and a related report on costs claimed (A-07-07-00240).[3] We present a summary of Nationwide's comments, as well as our responses, below. Nationwide's comments are included in their entirety as Appendix F.

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

Pension Costs Incurred Under Pre-Cost Accounting Standards Contracts

Auditee Comments

Nationwide stated that pension costs incurred under pre-CAS contracts should not increase the aggregate Medicare percentage. In addition, Nationwide stated that it had not been able to find Appendix B to its Medicare contract; therefore, according to Nationwide, our position on using the pension costs attributable to the Medicare contract was incorrect.

Furthermore, Nationwide did not agree that the "abnormal forfeiture" provision of the FPR applied to the segment closing. Nationwide cited a Federal Claims Court decision (Teledyne, Inc. vs. United States, 50 Fed. Cl. 155 (2001)) that, in Nationwide's view, prevented recoveries from prior periods. Nationwide stated: "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."

Office of Inspector General Response

Article XVI, Item B, of the Medicare contract states: ". . . [t]he total amount of allowable costs . . . in the performance of this agreement . . . shall be determined in accordance with the provisions of section 1-15.2 of the FPR, as [i]nterpreted and modified by Appendix B to this agreement . . . ." This reference to Appendix B demonstrates that the contract was subject to CAS 412 and 413 through FPR 1-15 and by direct incorporation of Appendix B, which was explicitly part of the contract.

Furthermore, we disagree with Nationwide's interpretation of the Teledyne decision. The Teledyne decision addressed the applicability limits of CAS 413 and concluded that CAS 413 could be applied only prospectively from the date of its first application, which was October 1, 1980 (the first day of FY 1981). Prior to October 1, 1980, the contract provisions were to be used in determining the recovery. Moreover, the Teledyne decision did not prevent recovery for periods prior to the CAS applicability; rather, it said only that CAS 413 could not be the basis for such recovery.

In light of the applicability limits of CAS 413, as delineated in the Teledyne decision, the FPR and contract clauses in effect prior to October 1, 1980, combined with the "no profit" requirement and the FAR credits clause, give the Government a right to an equitable adjustment

[3]Two areas of dispute ("1995 Cost Claimed" and "Federal Fiscal Year 1987–1988 Costs") related only to the costs claimed report; therefore, we will address those comments in that report.

for a contingent event that did not occur (and was previously unforeseeable) until the contract ended and employees were laid off.

The FPR was free to set forth measurement, assignment, and allocability rules for pensions and other deferred compensation for non-CAS-covered contracts for periods prior to FY 1981. In FY 1981, the FPR/FAR incorporated CAS 412 and 413 for FAR contracts.

New Cost Accounting Standards

Auditee Comments

Nationwide disagreed with the application of the revised CAS requirements to the update of assets from January 1, 1996, through June 30, 2002. Nationwide stated that the 1987 Medicare contract was the last contract executed with the Government; therefore, according to Nationwide, the 1995 revision to the CAS did not apply.

Office of Inspector General Response

We disagree that the CAS amended as of March 31, 1995 (revised CAS), did not apply to Nationwide's segmentation of the pension plan. The contract clearly imposed the FAR as modified on June 15, 1995, which incorporated the revised CAS 412 and 413. In addition, Nationwide's statement that there were no new contracts between CMS and Nationwide after 1987 is incorrect. The Medicare contracts are awarded annually to an incumbent contractor by consent; therefore, the revised CAS 412 and 413 were applicable to Nationwide's new contract (via automatic renewal) effective October 1, 1995.

Furthermore, Nationwide did not fully or consistently apply the provisions of the revised CAS throughout its update of Medicare segment assets. Nationwide said that the revised CAS did not apply for purposes of accounting for the Medicare segment assets from January 1, 1996, through the contract termination. However, Nationwide generally applied the revised CAS in determining Medicare's share of the excess assets by relying on CAS 413-50(c)(12)(vi), as amended.

Funding of 2002 Pension Costs

Auditee Comments

Nationwide disagreed that the 2002 pension costs were zero. Furthermore, it stated that we incorrectly excluded the 2002 contributions made after the segment closing from the calculation and that "even if the OIG [Office of Inspector General] 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." Nationwide also quoted a note in our working papers.

Office of Inspector General Response

Nationwide did not quote the entire text of the note in our working papers, which concluded: "This approach is consistent with the methodology used by Nationwide's actuary (Pine Cliff) as described in their report [submission] in footnote 63 on page V-11." Therefore, Nationwide was questioning its own methodology in treating the 2002 contribution.

Furthermore, the handling of the 2002 contribution did not have any impact on our calculations or findings. In fact, we used Nationwide's approach of excluding from the calculations the 2002 contribution made after the segment closing date. Nationwide was therefore incorrect in stating that we would have disallowed the contribution only because it was made after the segment closing date. We will address the differences in the computation of the allowable pension costs for 2002 in our costs claimed report.

Participant Transfers and Benefit Payments

Auditee Comments

Nationwide did not agree with the manner in which we handled participant transfers and benefit payments. In addition, it disagreed with the use of the actuarial valuation report instead of the IRS Form 5500 to identify the yearly total company benefit payments.

Office of Inspector General Response

Nationwide's treatment of the Medicare segment benefit payments was incorrect. From the date of retirement until the benefit liability and assets were transferred on the last day of the plan year, the benefit payments were paid from the Medicare segment's assets. Accordingly, Nationwide incorrectly charged the benefit payments to the "other" segment's assets.

We do not agree that the IRS Form 5500 is the appropriate document to identify the total company benefit payments. The benefit payments shown on the IRS Form 5500 were not actuarially verified. Therefore, we relied on the total company benefit payments reported in the actuarial valuation report.

Application of Prepayment Credits

Auditee Comments

Nationwide stated that it did not agree with our calculation of its CAS costs when prepayment credits were present. Nationwide said that our method was inequitable, violated provisions of the revised CAS, and diverged from prior Federal guidelines.

- Nationwide disagreed that the Federal Government had a right to the prepayment credits. It stated that the prepayments belonged to the contractor and that "[i]t simply does not make sense that the Government can reap a benefit . . . from an asset in which it has no ownership interest."

- Nationwide disagreed with our method of applying prepayment credits as of the beginning of the year. Nationwide said that prepayment credits are contractor monies applied at the discretion of the contractor and that the CAS permits, but does not require, prepayments to be applied as of the beginning of each plan year to fund current costs. Furthermore, Nationwide stated that the "New CAS 412" (i.e., the revised CAS) allowed the contractor ". . . to apply its prepayment credits before or after it applies its contributions, at its discretion."

- Nationwide questioned the application of FAR 31.201-1(a) as the basis for requiring the use of the prepayment credit as of the first day of the plan year.

- Nationwide questioned the audit approach of accounting for prepayments in the "other" segment until needed to fund future pension costs. Nationwide suggested that this approach contradicted the premise that prepayments are not associated with segments until they are allocated.

Office of Inspector General Response

Provided that current-year pension costs are funded by the tax filing deadline, the source or timing of the funding has no effect on the assignable and allocable pension costs determined under the CAS and is therefore not specifically addressed by the CAS. Instead, the timing of funding deposits affects the interest cost attributable to the delay in funding, which is allowable only in accordance with the FAR. Part 31 of the FAR defines the total costs under a contract as incurred costs and further requires that incurred costs be reasonable to be allowable.[4]

Our audit methodology reflected the fact that prepayment credits were available to fund the assignable pension cost as of the first day of the plan year. Nationwide had already made the decision to fund these monies into the pension trust, and, for that reason, these monies were unavailable to Nationwide for any purpose except to liquidate pension costs. It would not be reasonable for a prudent person in the conduct of competitive business to ignore the existence of an available funding credit and thereby incur increased interest costs. Therefore, any increased interest costs resulting from a delay in funding would be unreasonable and unallowable.

Contrary to Nationwide's assertion with respect to the adjustment of CAS pension costs, the preamble to the original CAS 412 did not contemplate the calculation of interest costs based on presumed funding dates. It simply stated that the standard does not prohibit an interest adjustment to pension costs from the valuation date to the date of funding. Furthermore, the allowability of interest/investment costs is the purview of the FAR.

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[4]FAR 31.201-2(a) provides that a cost is allowable only when it ". . . complies with the all of the following requirements: (1) Reasonableness. (2) Allocability. and (3) Standards promulgated by the CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances." FAR 31.201-3(a) defines a cost to be reasonable if ". . . in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business." Furthermore, FAR 31.201-3(a) provides that "[i]f an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer's representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable."

FAR 31.201-1 defines the costs under a contract as " . . . the sum of direct and indirect costs allocable to the contract, incurred or to be incurred . . . ." The FAR also provides that ". . . any generally accepted method of determining or estimating costs that is equitable and is consistently applied may be used." This language effectively counters Nationwide's assertion that our approach to the calculation of costs was inequitable. Nationwide's calculation of interest costs included costs that were not actually incurred. In fact, Nationwide's method of estimating incurred interest costs based on a presumed funding schedule was not equitable because it consistently overstated (maximized) the interest costs to the Federal Government.

CAS 413-50(c)(7) specifies that investment return and expenses are to be allocated among segments based on the WAV of assets for each segment. Nationwide's practice of adjusting contributions to the end of the year for purposes of asset rollup and allocation of investment returns did not conform to the required WAV methodology. Nationwide's incorrect allocation of investment income consequently affected the asset values for each segment and the resulting pension costs for all subsequent periods.

In addition, Nationwide's statement about accounting for prepayments in the "other" segment misinterpreted the methodology and intent laid out in the applicable CAS. Prepayment credits accounted for in the "other" segment are accumulated with interest at the valuation rate and subtracted from the assets of the "other" segment for purposes of computing audited pension costs, as required under CAS 412-50(a)(4). Prepayment credits are accounted for as part of the "other" segment only for purposes of allocating investment returns and expenses between the segments. This is necessary so that any gain or loss attributable to prepayments (resulting from a difference between the actual investment return and the valuation interest rate) is assigned to the "other" segment. Thus, the inclusion of prepayment credits with the assets of the "other" segment for the purpose of allocating investment returns is consistent with the premise that prepayment credits are the result of the plan sponsor's investment decision to fund amounts in excess of the assigned costs (rather than to retain the funds within the company). Accordingly, the Federal Government should not share in the investment risk or reward associated with those funds.

Asset Valuation Method

Auditee Comments

Nationwide stated that contractors were entitled to select their accounting practices. Nationwide quoted from its settlement proposal to CMS, which stated that "[t]he 1989 change in the ERISA [Employee Retirement Income Security Act of 1974] asset valuation method from account value to market value was not adopted for CAS purposes."

Office of Inspector General Response

We disagree with Nationwide's asset valuation contained in the proposal settlement prepared by its consultant, Pine Cliff. The CMS Office of the Actuary, in consultation with us, used Nationwide's actuarial value of assets because that was its established practice for Government contract costing and for ERISA. Throughout the audit period, Nationwide based its pension costs claimed on the Financial Accounting Standards 87 expense. The Financial Accounting Standards 87 expense calculation prepared by Pine Cliff was based on the market value of assets; therefore, it was Pine Cliff that decided to arbitrarily use a different asset valuation method long after the original calculation of assets had been completed. Pine Cliff's election to change Nationwide's asset valuation methodology from market value to account value constituted a retroactive change in accounting methodology, which violates paragraph II of Appendix B of the Medicare contract. Approval of changes in accounting practice must be requested from CMS in advance; however, Nationwide did not request such approval.

Allocation of Return

Auditee Comments

Nationwide disagreed with the inclusion of prepayment credits in the beginning-of-the-plan-year market value of assets used to allocate investment earnings for plan years prior to March 31, 1995.

Office of Inspector General Response

We determined that Nationwide's methodology for allocating the investment earnings using the beginning-of-the-plan-year market value of assets before the allocation of the annual prepayment credit was reasonable for plan years 1986 through 1995. We have revised our calculations accordingly.

Office of Inspector General Audit Approach

Auditee Comments

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.

Office of Inspector General Response

GAGAS allow the use of specialists (including actuaries) to assist in performing audits. We performed sufficient 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

MARKET VALUE OF PENSION ASSETS
FOR THE PERIOD
MARCH 1, 1986, TO JUNE 30, 2002

Description		**Total Company**	**Other Segment**	**Medicare**
Assets March 1, 1986	1/	$539,723,120	$531,612,161	$8,110,959
Prepayment credit		0	0	0
Contributions	2/	19,801,488	19,213,528	587,960
Other transaction	3/	(33,312)	(33,312)	0
Earnings	4/	94,762,249	93,338,162	1,424,087
Benefit payments	5/	(18,131,610)	(18,131,610)	0
Expenses	6/	(396,030)	(390,078)	(5,952)
Transfers	7/	0	305,771	(305,771)
Assets March 1, 1987		635,725,905	625,914,622	9,811,283
Prepayment credit		0	0	0
Contribution		31,419,137	30,899,952	519,185
Earnings		24,245,549	23,871,363	374,186
Benefit payments		(20,274,420)	(20,260,701)	(13,719)
Expenses		(628,383)	(618,685)	(9,698)
Transfers		0	358,959	(358,959)
Assets March 1, 1988		670,487,788	660,165,510	10,322,278
Prepayment credit		0	0	0
Contribution		0	0	0
Earnings		59,889,385	58,967,377	922,008
Benefit payments		(23,583,216)	(23,549,238)	(33,978)
Expenses		0	0	0
Transfers		0	1,104,630	(1,104,630)
Assets March 1, 1989		706,793,957	696,688,279	10,105,678
Prepayment credit		0	0	0
Contributions		17,564,538	16,922,794	641,744
Other transaction		46,912,601	46,912,601	0
Earnings		112,925,070	111,310,477	1,614,593
Benefit payments		(22,113,981)	(22,113,981)	0
Expenses		0	0	0
Transfers		0	417,679	(417,679)
Assets January 1, 1990		$862,082,185	$850,137,849	$11,944,336

MARKET VALUE OF PENSION ASSETS
FOR THE PERIOD
MARCH 1, 1986, TO JUNE 30, 2002

Description		**Total Company**	**Other Segment**	**Medicare**
Assets January 1, 1990		$862,082,185	$850,137,849	$11,944,336
Prepayment credit		0	0	0
Contribution		36,952,880	35,847,846	1,105,034
Earnings		42,730,834	42,138,789	592,045
Benefit payments		(30,775,688)	(30,764,286)	(11,402)
Expenses		0	0	0
Transfers		0	640,727	(640,727)
Assets January 1, 1991		910,990,211	898,000,925	12,989,286
Prepayment credit	8/	0	(375,489)	375,489
Contribution		35,446,721	34,551,736	894,985
Earnings		173,141,898	170,673,167	2,468,731
Benefit payments		(34,045,100)	(34,032,457)	(12,643)
Expenses		0	0	0
Transfers		0	530,206	(530,206)
Assets January 1, 1992		1,085,533,730	1,069,348,088	16,185,642
Prepayment credit		0	(1,120,165)	1,120,165
Contributions		0	0	0
Earnings		62,306,533	61,377,523	929,010
Benefit payments		(37,274,039)	(37,250,269)	(23,770)
Expenses		0	0	0
Transfers		0	792,824	(792,824)
Assets January 1, 1993		1,110,566,224	1,093,148,001	17,418,223
Prepayment credit		0	(448,266)	448,266
Contribution		38,090,934	37,202,431	888,503
Earnings		105,001,748	103,354,891	1,646,857
Benefit payments		(40,845,626)	(40,830,618)	(15,008)
Expenses		0	0	0
Transfers		0	820,126	(820,126)
Assets January 1, 1994		$1,212,813,280	$1,193,246,565	$19,566,715

MARKET VALUE OF PENSION ASSETS
FOR THE PERIOD
MARCH 1, 1986, TO JUNE 30, 2002

Description	Total Company	Other Segment	Medicare
Assets January 1, 1994	$1,212,813,280	$1,193,246,565	$19,566,715
Prepayment credit	0	(548,906)	548,906
Contribution	61,575,528	60,259,886	1,315,642
Earnings	21,495,429	21,148,636	346,793
Benefit payments	(43,613,254)	(43,606,177)	(7,077)
Expenses	0	0	0
Transfers	0	897,921	(897,921)
Assets January 1, 1995	1,252,270,983	1,231,397,925	20,873,058
Prepayment credit	0	(848,690)	848,690
Contribution	69,866,725	68,762,517	1,104,208
Other transaction	229,186,211	229,186,211	0
Earnings	250,721,279	246,542,216	4,179,063
Benefit payments	(50,806,376)	(50,802,502)	(3,874)
Expenses	0	0	0
Transfers	0	1,201,597	(1,201,597)
Assets January 1, 1996	1,751,238,822	1,725,439,274	25,799,548
Prepayment credit	0	(800,781)	800,781
Contribution	54,252,647	53,757,726	494,921
Other transaction	975,000	975,000	0
Earnings	209,467,095	206,230,158	3,236,937
Benefit payments	(68,143,108)	(68,063,965)	(79,143)
Expenses	(16,400)	(16,147)	(253)
Transfers	0	308,994	(308,994)
Assets January 1, 1997	1,947,774,056	1,917,830,259	29,943,797
Prepayment credit	0	(108,567)	108,567
Contribution	43,692,730	43,620,747	71,983
Other transaction	1,071,376	1,071,376	0
Earnings	328,156,475	323,006,597	5,149,878
Benefit payments	(71,391,922)	(71,307,563)	(84,359)
Expenses	0	0	0
Transfers	0	1,330,658	(1,330,658)
Assets January 1, 1998	$2,249,302,715	$2,215,443,507	$33,859,208

MARKET VALUE OF PENSION ASSETS
FOR THE PERIOD
MARCH 1, 1986, TO JUNE 30, 2002

Description	Total Company	Other Segment	Medicare
Assets January 1, 1998	$2,249,302,715	$2,215,443,507	$33,859,208
Prepayment credit	0	0	0
Contribution	80,037,311	80,037,311	0
Other transaction	(377,498,698)	(377,498,698)	0
Earnings	300,752,214	296,150,506	4,601,708
Benefit payments	(75,748,510)	(75,710,075)	(38,435)
Expenses	0	0	0
Transfers	0	2,202,047	(2,202,047)
Assets January 1, 1999	2,176,845,032	2,140,624,598	36,220,434
Prepayment credit	0	0	0
Contribution	0	0	0
Other transaction	(8,494,924)	(8,494,924)	0
Earnings	171,437,837	168,541,286	2,896,551
Benefit payments	(72,356,210)	(72,251,203)	(105,007)
Expenses	0	0	0
Transfers	0	2,013,015	(2,013,015)
Assets January 1, 2000	2,267,431,735	2,230,432,772	36,998,963
Prepayment credit	0	0	0
Contribution	0	0	0
Earnings	140,948,634	138,612,632	2,336,002
Benefit payments	(73,584,774)	(73,525,526)	(59,248)
Expenses	0	0	0
Transfers	0	1,379,382	(1,379,382)
Assets January 1, 2001	2,334,795,595	2,296,899,260	37,896,335
Prepayment credit	0	0	0
Contribution	0	0	0
Earnings	(47,666,716)	(46,879,048)	(787,668)
Benefit payments	(86,445,111)	(86,386,543)	(58,568)
Expenses	0	0	0
Transfers	0	1,119,725	(1,119,725)
Assets January 1, 2002	$2,200,683,768	$2,164,753,394	$35,930,374

MARKET VALUE OF PENSION ASSETS
FOR THE PERIOD
MARCH 1, 1986, TO JUNE 30, 2002

Description		Total Company	Other Segment	Medicare
Assets January 1, 2002		$2,200,683,768	$2,164,753,394	$35,930,374
Prepayment credit		0	0	0
Contribution		0	0	0
Earnings		(80,820,698)	(79,491,384)	(1,329,314)
Benefit payments		(42,623,317)	(42,453,851)	(169,466)
Expenses		0	0	0
Transfers		0	0	0
Assets June 30, 2002		$2,077,239,753	$2,042,808,159	$34,431,594
Per Nationwide	9/	$2,077,239,753	$2,044,798,524	$32,441,229
Asset Variance	10/	$0	($1,990,365)	$1,990,365

FOOTNOTES

1/ We calculated the Medicare segment assets based on our computed asset fraction (1.5028 percent). We computed the asset fraction as explained in the "Findings and Recommendations" section of the report. 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/ 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.

3/ We obtained the other transactions from documents prepared by Nationwide's actuarial consulting firm. "Other" transactions represent plan mergers and spinoffs. The "other" transactions did not affect the Medicare segment assets.

4/ We obtained investment earnings from actuarial valuation reports. We allocated investment earnings based on the market value of Medicare assets at the beginning of the plan year after adjustment for transfers. For years starting with 1996, 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 calculated the Medicare segment's benefit payments based on actual payments to Medicare segment retirees. We obtained information on the benefit payments from documents prepared by Nationwide's actuarial consulting firm.

6/ We allocated administrative expenses to the Medicare segment in proportion to investment earnings.

7/ We identified participant transfers between segments based on the proposal settlement provided by Nationwide's actuarial consulting firm. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. For transfers that occurred prior to the 1996 plan year, asset transfers reflected the funding level of the segment from which the participant transferred based on the actuarial liability and the asset value used for cost purposes. We calculated the funding level as the assets divided by the liabilities. If the funding level was greater than 1, the assets transferred between the segments were equal to the participants' actuarial accrued liability. For plan years starting with 1996, asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with the CAS.

8/ Prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current-year contributions to reduce interest costs to the Federal Government. Prepayment credits are transferred to the Medicare segment as needed to cover funding requirements.

9/ We obtained total asset amounts as of June 30, 2002, from documents prepared by Nationwide's actuarial consulting firm.

10/ The asset variance represents the difference between our calculation of Medicare segment assets and Nationwide's market value of assets.

COMPARISION OF ASSET FRACTION

Initial Allocation of Medicare Segment Asset Variance					
Calculation	**1981 Medicare Actuarial Liability**	**1981 Total Company Actuarial Liability**	**1981 Rounded Asset Fraction**	**1986 Total Company Assets**	**1986 Medicare Segment Assets**
	(A)	(B)	(C)	(D)	(E)
			(A) / (B)		(C) x (D)
Per Audit	$4,681,208	$311,507,700	1.5028%	$539,723,120	$8,110,959
Per Nationwide	4,690,266	312,169,208	1.5020%	539,723,120	8,106,641
Difference	**($9,058)**	**($661,508)**	**0.0008%**	**$0**	**$4,318**

APPENDIX C

COMPARISION OF CONTRIBUTIONS AND PREPAYMENT CREDITS

Contributions and Prepayment Credits			
Year	**Per Audit**	**Per Nationwide**	**Difference**
1986	$587,960	$587,960	$0
1987	519,185	519,185	0
1988	0	0	0
1989	641,744	549,700	92,044
1990	1,105,034	1,288,677	(183,643)
1991	1,270,474	1,474,004	(203,530)
1992	1,120,165	0	1,120,165
1993	1,336,769	1,595,925	(259,156)
1994	1,864,548	2,269,976	(405,428)
1995	1,952,898	2,315,572	(362,674)
1996	1,295,702	1,384,556	(88,854)
1997	180,550	0	180,550
1998	0	446,284	(446,284)
1999	0	0	0
2000	0	0	0
2001	0	0	0
2002	0	734,280	(734,280)
Total	**$11,875,029**	**$13,166,119**	**($1,291,090)**

COMPARISION OF NET ASSET TRANSFERS **APPENDIX D**

Net Asset Transfers			
Year	**Per Audit**	**Per Nationwide**	**Difference**
1986	($305,771)	($305,772)	$1
1987	(358,959)	(372,678)	13,719
1988	(1,104,630)	(1,138,608)	33,978
1989	(417,679)	(417,679)	0
1990	(640,727)	(652,129)	11,402
1991	(530,206)	(542,849)	12,643
1992	(792,824)	(816,594)	23,770
1993	(820,126)	(835,134)	15,008
1994	(897,921)	(904,998)	7,077
1995	(1,201,597)	(1,205,471)	3,874
1996	(308,994)	95,024	(404,018)
1997	(1,330,658)	(2,393,526)	1,062,868
1998	(2,202,047)	(3,948,208)	1,746,161
1999	(2,013,015)	(2,425,533)	412,518
2000	(1,379,382)	(1,515,048)	135,666
2001	(1,119,725)	(1,332,723)	212,998
2002	0	0	0
Total	**($15,424,261)**	**($18,711,926)**	**$3,287,665**

CALCULATION OF AGGREGATE MEDICARE PERCENTAGE **APPENDIX E**

Plan Year Beginning	Medicare Segment Employer Contributions	Medicare Segment Employee Contributions	Medicare Segment Total	
03/01/1966	$80,535	$614	$81,149	
03/01/1967	124,427	949	125,376	
03/01/1968	128,160	977	129,137	
03/01/1969	132,005	1,006	133,011	
03/01/1970	135,965	1,036	137,001	
03/01/1971	140,044	1,067	141,111	
03/01/1972	144,245	1,099	145,344	
03/01/1973	148,572	1,132	149,704	
03/01/1974	153,029	1,166	154,195	
03/01/1975	157,620	1,201	158,821	
03/01/1976	162,349	1,237	163,586	
03/01/1977	217,663	1,274	218,937	
03/01/1978	212,539	1,422	213,961	
03/01/1979	177,408	1,467	178,875	
03/01/1980	229,099	0	229,099	
03/01/1981	573,528	0	573,528	
03/01/1982	714,010	0	714,010	
03/01/1983	625,843	0	625,843	
03/01/1984	712,600	0	712,600	
03/01/1985	829,857	0	829,857	
03/01/1986	587,960	0	587,960	
03/01/1987	519,185	0	519,185	
03/01/1988	0	0	0	
03/01/1989	641,744	0	641,744	
01/01/1990	1,105,034	0	1,105,034	
01/01/1991	1,270,474	0	1,270,474	
01/01/1992	1,112,444	0	1,112,444	
01/01/1993	1,321,779	0	1,321,779	
01/01/1994	1,845,666	0	1,845,666	
01/01/1995	1,933,804	0	1,933,804	
01/01/1996	940,803	0	940,803	
01/01/1997	173,835	0	173,835	
01/01/1998	0	0	0	
01/01/1999	0	0	0	
01/01/2000	0	0	0	
01/01/2001	0	0	0	
01/01/2002	0	0	0	
06/30/2002	0	0	0	
Total	**$17,252,226**	**$15,647** 1/	**$17,267,873**	**99.91%** 2/

1/ Nationwide's calculation of the aggregate Medicare percentage, which included employee contributions in the denominator but excluded them from the numerator, in effect excluded the minor portion of the excess assets attributable to employee contributions. Although this was not the proper way to determine the excess assets attributable to employee contributions, we accepted Nationwide's methodology because it did not yield a material difference.

2/ We calculated the aggregate Medicare percentage by dividing the total contributions made to the Medicare segment that were employer related (numerator) by the total Medicare segment contributions (denominator).

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).

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 $1,644,4*17*. 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]

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

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. See, e.g., 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	Other Segment: Prepayment Credit	Other Segment: 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

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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

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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.

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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.

Teresa J. Potts

Teresa J. Potts
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Nationwide Mutual Insurance Company

Dated: April 3, 2008