



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

APR 06 2009

Report Number: A-07-09-00307

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

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

Dear Ms. Abraham:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of the Pension Costs Claimed for Medicare Reimbursement by Blue Cross Blue Shield of Arizona for Fiscal Year 2006." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, OIG reports generally are made available to the public to the extent that information in the report is not subject to exemptions in the Act. 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-07-09-00307 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Mr. Timothy Hill, Director & Chief Financial Officer
Office of Financial Management
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Mail Stop C3-01-24
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Baltimore, Maryland 21244-1850

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF THE PENSION COSTS
CLAIMED FOR MEDICARE
REIMBURSEMENT BY
BLUE CROSS BLUE SHIELD OF
ARIZONA FOR
FISCAL YEAR 2006**



Daniel R. Levinson
Inspector General

April 2009
A-07-09-00307

Office of Inspector General

<http://oig.hhs.gov>

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

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

OBJECTIVE

Our objective was to determine the allowability of pension costs claimed by Arizona for Medicare reimbursement for fiscal year (FY) 2006.

SUMMARY OF FINDING

Arizona did not claim \$1,635 of allowable pension costs on its Final Administrative Cost Proposal (FACP) for FY 2006. This underclaim occurred primarily because Arizona incorrectly computed the allowable pension costs for the Other segment. Therefore, Arizona did not claim \$1,635 of allowable pension costs.

RECOMMENDATION

We recommend that Arizona revise its FACP for FY 2006 to claim the additional allowable pension costs of \$1,635.

AUDITEE COMMENTS

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

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INTRODUCTION

BACKGROUND

Blue Cross Blue Shield of Arizona

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

Medicare Reimbursement

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

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

OBJECTIVE, SCOPE AND METHODOLOGY

Objective

Our objective was to determine the allowability of pension costs claimed by Arizona for Medicare reimbursement for fiscal year (FY) 2006.

Scope

We reviewed pension costs that Arizona claimed for Medicare reimbursement on its Final Administrative Cost Proposal (FACP) for FY 2006. Achieving the objective did not require that we review Arizona's overall internal control structure. However, we did review the internal controls related to the pension costs claimed for Medicare reimbursement to ensure that the pension costs were allocable in accordance with the CAS and allowable in accordance with the FAR.

We performed fieldwork at our field office, located in Jefferson City, Missouri.

Methodology

We reviewed the applicable portions of the Medicare contracts, FAR, and CAS to determine the Federal requirements for pension plans.

We identified Arizona's CAS pension costs for the Medicare segment and Other segment. We also determined the extent to which Arizona funded CAS pension costs with contributions to the pension trust fund and accumulated prepayment credits. We based our calculations on separately computed CAS pension costs for the Medicare segment and the Other segment CAS pension costs. The CMS Office of the Actuary calculated the allocable CAS pension costs based on Arizona's historical practices and on the results of our segmentation review ("Review of the Pension Segmentation Requirements for the Qualified Pension Plan at Blue Cross Blue Shield of Arizona, a Terminated Medicare Contractor, for the Period January 1, 2005, to September 30, 2006" A-07-09-00306). Appendix A contains details on the pension costs and contributions.

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

We conducted this performance audit in accordance with generally accepted government auditing standards. 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 finding and conclusions based on our audit objective.

FINDING AND RECOMMENDATION

Arizona did not claim \$1,635 of allowable pension costs on its FACP for FY 2006. This underclaim occurred primarily because Arizona incorrectly computed the allowable pension costs for the Other segment. Therefore, Arizona did not claim \$1,635 of allowable pension costs.

FEDERAL REQUIREMENTS

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

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

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

CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

PENSION COSTS UNDERCLAIMED

Arizona did not claim \$1,635 of allowable pension costs on its FACP for FY 2006.

For FY 2006, Arizona claimed pension costs of \$357,930 for Medicare reimbursement. We calculated the allowable pension costs based on separately computed CAS pension costs for the Medicare segment and the Other segment, in accordance with CAS 412 and 413. We determined that the allowable CAS pension costs for FY 2006 were \$359,565.

The underclaim occurred primarily because Arizona incorrectly computed the allowable pension costs for the Other segment. Arizona separately computed the CAS pension costs for the Medicare segment and the Other segment. However, when determining the Other segment allowable pension costs, Arizona incorrectly subtracted the Medicare segment CAS pension costs from the Other segment CAS pension costs. Therefore, Arizona used an incorrect CAS pension cost amount when calculating the allowable pension costs for the Other segment. As a result, Arizona did not claim \$1,635 of allowable pension costs.

RECOMMENDATION

We recommend that Arizona revise its FACP for FY 2006 to claim the additional allowable pension costs of \$1,635.

AUDITEE COMMENTS

In written comments on our draft report, Arizona agreed with our recommendation. Arizona stated that it will work with CMS to increase claimed pension costs by \$1,635 on settlement of the FACP for FY 2006.

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

APPENDIXES

BLUE CROSS BLUE SHIELD OF ARIZONA
STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEAR 2006

| Date | Description | Total Company | Other Segment | Medicare Segment |
|-------|-----------------------------|-----------------------------|------------------|------------------|
| 2005 | Contributions | <u>1/</u> \$0 | \$0 | \$0 |
| 8.00% | Discount For Interest | <u>2/</u> 0 | 0 | 0 |
| | Present Value Contributions | <u>3/</u> 0 | 0 | 0 |
| | Prepayment Credit Applied | <u>4/</u> 8,226,794 | 7,931,101 | 295,693 |
| | Present Value Of Funding | <u>5/</u> 8,226,794 | 7,931,101 | 295,693 |
| | CAS Funding Target | <u>6/</u> 8,226,794 | 7,931,101 | 295,693 |
| | Percentage Funded | <u>7/</u> | 100.00% | 100.00% |
| | Funded Pension Cost | <u>8/</u> | 7,931,101 | 295,693 |
| | Allowable Interest | <u>9/</u> | 0 | 0 |
| | Allocable Pension Cost | <u>10/</u> | 7,931,101 | 295,693 |
| 2006 | Contributions | \$0 | \$0 | \$0 |
| 8.00% | Discount For Interest | 0 | 0 | 0 |
| | Present Value Contributions | 0 | 0 | 0 |
| | Prepayment Credit Applied | <u>6,774,927</u> | <u>6,547,857</u> | <u>227,070</u> |
| | Present Value Of Funding | 6,774,927 | 6,547,857 | 227,070 |
| | CAS Funding Target | 6,774,927 | 6,547,857 | 227,070 |
| | Percentage Funded | | 100.00% | 100.00% |
| | Funded Pension Cost | | <u>6,547,857</u> | <u>227,070</u> |
| | Allowable Interest | | 0 | 0 |
| | Allocable Pension Cost | <u>11/</u> | 6,547,857 | 227,070 |
| 2006 | Fiscal Year Pension Cost | <u>12/</u> | 8,530,632 | 300,993 |
| | Medicare LOB Percentage* | <u>13/</u> | 0.76% | 97.92% |
| | Allowable Pension Cost | <u>14/</u> <u>\$359,565</u> | <u>\$64,833</u> | <u>\$294,732</u> |

* Line of business

FOOTNOTES

1/ We obtained Total Company contribution amounts and dates of deposit from Internal Revenue Service Form 5500 reports. The contributions included deposits made during the plan year and accrued contributions deposited after the end of the plan year but within the time allowed for filing tax returns. The contributions allocated to the Medicare segment were determined during the pension segmentation review (A-07-09-00306). The amounts shown for the Other segment represent the difference between the Total Company and the Medicare segment.

BLUE CROSS BLUE SHIELD OF ARIZONA
STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEAR 2006

APPENDIX A
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- 2/ We subtracted the interest that is included in the contributions deposited after the beginning of the valuation year to discount the contributions back to their beginning-of-the-year value. For purposes of this Appendix, we computed the interest as the difference between the present value of contributions (at the valuation interest rate) and actual contribution amounts.
- 3/ The present value of contributions is the value of the contributions discounted from the date of deposit back to the first day of the plan year. For purposes of this Appendix, we deemed deposits made after the end of the plan year to have been made on the final day of the plan year, consistent with the method mandated by the Employee Retirement Income Security Act.
- 4/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year Cost Accounting Standards (CAS) funding target. A prepayment credit is carried forward, with interest, to fund future CAS pension costs.
- 5/ The present value of funding represents the present value of contributions plus prepayment credits. This is the amount of funding that is available to cover the CAS funding target measured at the first day of the plan year.
- 6/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of the Federal Acquisition Regulation (FAR) 31.205-6(j)(2)(i).
- 7/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Because any funding in excess of the CAS funding target is accounted for as a prepayment in accordance with CAS 412.50(c)(1) (as amended), the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS funding target. For purposes of illustration, the percentage of funding has been rounded to four decimals.
- 8/ We computed the funded CAS pension cost as the CAS funding target multiplied by the percent funded.
- 9/ We assumed that interest on the funded CAS pension cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(j)(2)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target, less the prepayment credit, were funded in four equal installments deposited within 30 days after the end of the quarter.
- 10/ The allocable CAS pension cost is the amount of pension cost that may be allocated for contract cost purposes.
- 11/ Arizona terminated its Medicare contract on September 30, 2006. Therefore, the 2006 allocable pension costs were for only a 9-month period (January 1 to September 30).

BLUE CROSS BLUE SHIELD OF ARIZONA
STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEAR 2006

APPENDIX A
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- 12/ As stated above in footnote 11, the 2006 allocable pension costs were for a 9-month period. To calculate the fiscal year (FY) 2006 allocable pension costs, we calculated the FY pension costs as 1/4 of the prior year's costs plus all of the current year's costs. Costs charged to the Medicare contract should consist of the Medicare segment's direct pension costs plus pension costs attributable to indirect Medicare operations.
- 13/ We calculated allowable pension costs of the Medicare and Other segments based on the Medicare line of business percentage for each segment. We obtained the percentages from documents provided by Arizona.
- 14/ We computed the allowable Medicare pension cost as the FY pension cost multiplied by the Medicare line of business percentage.



An Independent Licensee
of the Blue Cross and
Blue Shield Association

March 30, 2009

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

Refer to: A-07-09-00307

Dear Mr. Cogley:

The purpose of this letter is to submit our response to the Department of Health and Human Services Office of Inspector General's draft report entitled "Review of the Pension Costs Claimed for Medicare Reimbursement by Blue Cross Blue Shield of Arizona for Fiscal Year 2006."

We agree with the report recommendation and will take the following action to ensure the report recommendation is implemented.

- Work with the Centers for Medicare and Medicaid Services to increase claimed pension costs by \$1,635 on settlement of the Final Administrative Cost Proposal for FY 2006.

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

Sincerely

A handwritten signature in black ink that reads "Suzy Mortenson".

Suzy Mortenson
Director of Finance

Cc: Jay Pinkerton, CCA Strategies LLC
Megan Seehafer, OIG/OAS
Jeffrey Wilson, OIG/OAS
Eric Shipley, CMS
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