Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF PENSION COSTS CLAIMED FOR MEDICARE REIMBURSEMENT BY INDEPENDENCE BLUE CROSS

JANET REHNQUIST
Inspector General

FEBRUARY 2002
A-07-01-03003

Office of Inspector General

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DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

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

CIN: A-07-01-03003
February 26, 2002

Mr. John Foos
Chief Financial Officer
Independence Blue Cross
1901 Market Street
Philadelphia, PA 19103-1480

Dear Mr. Foos:

This report provides the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Pension Costs Claimed for Medicare Reimbursement by Independence Blue Cross*. The purpose of our review was to determine the allowability of pension costs claimed for Medicare reimbursement for Fiscal Years (FY's) 1987 through 1997.

During this period, the allowable Medicare pension costs were $2,150,995. However, IBC claimed pension costs of $1,051,012 for Medicare reimbursement. As a result, IBC did not claim $1,099,983 in allowable pension costs. This under claim of pension costs primarily occurred because IBC neglected to include certain pension contribution amounts on their Final Administrative Cost Proposals (FACPs).

We recommend IBC revise its FACPs to reflect the remaining allowable pension costs. While IBC agreed that any costs not claimed per its identification of the Medicare segment would be reimbursable, it did not agree with our identification of the segment. Therefore, to the extent that IBC disagreed with our identification of the segment, it also disagreed with our finding. IBC's response is included in its entirety as Appendix B. Appendix C contains the Centers for Medicare and Medicaid Services (CMS), Office of the Actuary's comments on IBC's response.

INTRODUCTION

BACKGROUND

IBC administered Medicare Part A operations under cost reimbursement contracts until the contractual relationship terminated in 1997. Medicare contractors must follow cost reimbursement principles contained in the Cost Accounting Standards (CAS), the Federal Acquisition Regulations (FAR), and their Medicare contracts.

Medicare reimburses its portion of contractors' annual pension costs. To be allowable for Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with CAS 412 and 413, and (2) funded as specified by Part 31 of the FAR.

The CAS deals with stability between contract periods and requires consistent measurement and assignment of pension costs to contract periods. The CAS costs that are allowable as charges to Medicare include (1) the normal cost and (2) the amortization of the unfunded actuarial liability.

The FAR addresses allowability of pension costs and requires that pension costs assigned to contract periods be substantiated by funding.

Additionally, CMS (formerly the Health Care Financing Administration) incorporated specific segmentation language into Medicare contracts. The contracts provide for either an allocation or a separate calculation of pension costs. Under an allocation method, a contractor determines total plan CAS costs and allocates a share to Medicare. Under the separate calculation method, a contractor separately identifies the normal costs and amortization for the Medicare segment. The separate calculation method must be used if there is a material difference between the two methods.

OBJECTIVES, SCOPE AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine the allowability of pension costs claimed for FY's 1987 through 1997. Achieving the objective did not require a review of IBC's internal control structure.

This review was done in conjunction with our audit of pension segmentation for a terminated contractor (CIN: A-07-01-00132). The information obtained and reviewed during those audits was also used in performing this review.

In performing the review, we used information provided by Pricewaterhouse Coopers, IBC's consulting actuary. We also reviewed IBC's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s (DOL/IRS Form 5500s). Using this information, we calculated CAS pension costs that are allowable for Medicare reimbursement for FY's 1987 through 1997. Appendix A contains the details on the pension costs and contributions.

The CMS Office of the Actuary developed the methodology used for computing allowable CAS pension costs based on IBC's historical practices. We performed site work during January 2000 at IBC's corporate offices in Philadelphia. Subsequently, we performed audit work in the OIG, OAS, Jefferson City, Missouri Field Office.

FINDING AND RECOMMENDATION

For FY's 1987 through 1997, IBC did not claim $1,099,983 in pension costs that were allowable for Medicare reimbursement. The pension costs are allowable because the funded portion of CAS computed costs exceeded the costs claimed. The under claim of pension costs primarily occurred because IBC neglected to include certain pension contribution amounts on their FACPs. IBC should revise its FACPs to reflect the additional CAS pension costs that were allowable for reimbursement.

IBC assigned pension costs to Medicare based upon an allocation of actual contributions to its pension trust fund. However, IBC only included an allocable portion of the contributions that were actually deposited at the time the FACPs were filed each year. Consequently, IBC did not claim Medicare reimbursement for any portion of the pension contributions that were deposited after the FACPs were filed. Additionally, due to budget constraints, IBC did not file supplemental or amended FACPs to include the additional pension contributions made after the original filings.

We calculated the allowable CAS pension costs for the Medicare segment and for Medicare indirect operations. The calculations were based on separately computed CAS pension costs for the Medicare segment and total company CAS pension costs. See Appendix A for details.
We compared our calculated allowable CAS pension costs to the pension costs claimed on IBC's FACPs and found:

Cost Claimed Variance

YEAR	PER IBC	PER OIG	VARIANCE
1987	$ 371,948	$ 287,661	$ 84,287
1988	72,916	152,322	(79,406)
1989	0	77,970	(77,970)
1990	146,012	275,860	(129,848)
1991	0	31,975	(31,975)
1992	0	190,054	(190,054)
1993	140,162	248,204	(108,042)
1994	139,001	116,007	22,994
1995	79,800	315,746	(235,946)
1996	101,173	269,461	(168,288)
1997	0	185,735	(185,735)
	$ 1,051,012	$ 2,150,995	$ (1,099,983)

For 1987 through 1997, IBC claimed pension costs of $1,051,012 for Medicare reimbursement. However, the allowable CAS pension costs were $2,150,995. As a result, IBC could have claimed $1,099,983 in additional CAS pension costs.

Recommendation

We recommend that IBC:

- Revise its FACPs for FY's 1987 through 1997 to claim additional allowable CAS pension costs of $1,099,983.

Auditee Response

IBC disagreed with our report and stated:

> *…to the extent the Government arrived at any portion of the allowable costs in the Pension Cost Report based on a different identification of the segment, IBC reserves the right to contest the Report's conclusions.*

IBC implied that the difference between our allowable Medicare segment CAS pension costs and the pension costs IBC claimed for Medicare reimbursement was the result of differing segment identifications. IBC's response stated:

> *…it appears that the Government's identification of the segment is an important factor in the Pension Cost Report's conclusions. We suspect that the Government's segment identification was substantially the same as the identification used in the Termination Report. Indeed, we suspect that the Government's redetermination of IBC's segment identification used in performing the required termination calculations likely led to and significantly influenced the Government's separate pension cost calculations.*

IBC asserted that our report did not identify our interpretation of the segment's identification and how that identification pertained to computing the allowable costs. Also, IBC contended that additional information requested subsequent to the issuance of this report in draft did not answer its questions concerning unclaimed contributions.

OIG Comments

Our comments are summarized in the following paragraphs. The CMS, Office of the Actuary's detailed comments on IBC's response are presented on Appendix C. Additional information on the issue of the identification of the Medicare segment is contained in our report titled *Audit of the Pension Plan at a Terminated Medicare Contractor, Independence Blue Cross* (CIN: A-07-01-00132).

IBC claimed Medicare segment pension costs of $1,051,012. We determined the allowable segment pension costs to be $2,150,995. Therefore, IBC under claimed CAS pension costs by $1,099,983. IBC assumed that the difference was due to different identifications of the segment. However, this assumption is incorrect.

There were few differences between our identification of the segment and IBC's for the years 1986 through 1988. For years 1989 forward, our identification of the Medicare segment and IBC's were identical. We provided IBC with a copy of our crosswalk of Medicare segment cost centers. This crosswalk clearly showed that we were virtually in agreement concerning the segment identification.

We determined that the reasons for the under claim were due to two factors. First, IBC did not claim Medicare reimbursement for any contributions made after a plan year ended. Second, IBC did not claim any costs in excess of their budgeted amount. IBC filed only one FACP per year and it was filed at the budgeted limit. IBC didn't file a revised FACP for any additional costs because it believed these costs would not be reimbursed. However, these additional costs could have been claimed by IBC and submitted to Medicare for reimbursement. Had IBC claimed all allowable pension costs, its costs claimed should have been reasonably similar to our computation of allowable costs.

As for IBC's assertion that we did not supply them with sufficient information to determine our methodology, we disagree. While IBC requested data pertaining to the contract termination and segment closing report (CIN: A-07-01-00132), no additional data was requested for this report. Therefore, we did not provide additional data or specifically address details concerning this report. However, IBC had all the data it needed to analyze the difference between our computation of allowable costs and its costs claimed.

To determine the allowable Medicare segment pension costs, we used data provided to us by IBC. We assume that IBC had access to this information as well. We also held various meetings with IBC staff and counsel while we were on-site. Additionally, we provided our CAS cost worksheet that showed the details of our pension cost computations. Furthermore, we provided them with the above-mentioned crosswalk of Medicare segment cost centers. That crosswalk shows that the difference in calculated pension costs was not due to varying segment identifications. Finally, this report clearly points out that the difference was primarily due to IBC not claiming all allowable costs. Therefore, IBC's assertion concerning insufficient data is unfounded.

Certain amounts were revised subsequent to the issuance of the draft report. The amounts presented in this final report reflect those revisions. See Appendix A, Footnote 16, for further details.

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determinations as to actions to be taken on all matters reported will be made by the CMS action official identified below. We request that you respond to the recommendation in this report within 30 days form the date of this report to the CMS action official, presenting any comments or additional information that you believe may have a bearing on final determination.

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. 552, as amended by Public Law 104-231, Office of Inspector General, Office of Audit Services reports are made available to the public to the extent information contained therein is not subject to exemptions in the Act. (See 45 CFR Part 5). As such, within ten business days after the final report is issued, it will be posted on the worldwide web at http://oig.hhs.gov/.

Sincerely,

James P. Aasmundstad

James P. Aasmundstad
Regional Inspector General
for Audit Services, Region VII

Enclosures
CMS Action Official:

Charlene Brown
Regional Administrator, Region III
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Philadelphia, PA 19106-3499

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CIN: A-07-01-03003
STATEMENT OF ALLOWABLE CAS PENSION COSTS
FOR FISCAL YEARS 1987 THROUGH 1997

Date	Description		Total Company	Other Segment	Medicare Segment
1986	Contributions	1/	$2,759,155	$2,538,111	$221,044
	Discount For Interest	2/	(127,739)	(117,505)	(10,234)
7/1/86	Present Value Contributions	3/	2,631,416	2,420,606	210,810
7/1/86	Prepayment Credit	4/	0	0	0
7/1/86	Present Value Of Funding	5/	2,631,416	2,420,606	210,810
7/1/86	CAS Pension Costs	6/	2,450,026	2,239,216	210,810
7/1/86	Absorbed Credit	7/	0	0	0
7/1/86	CAS Funding Target	8/	2,450,026	2,239,216	210,810
7/1/86	Percentage Funded	9/		100.00%	100.00%
7/1/86	Funded Pension Cost	10/		2,239,216	210,810
	Allowable Interest	11/		108,700	10,234
	Allocable Pension Cost	12/		2,347,916	221,044
	Fiscal Year Pension Cost	13/		0	0
	Medicare LOB Percentage	14/		0.00%	0.00%
	Allowable Pension Cost	15/	$0	$0	$0

Date	Description	Total Company	Other Segment	Medicare Segment
1987	Contributions	$1,200,000	$1,075,683	$124,317
	Discount For Interest	(59,262)	(53,123)	(6,139)
7/1/87	Present Value Contributions	1,140,738	1,022,560	118,178
7/1/87	Prepayment Credit	195,902	175,607	20,295
7/1/87	Present Value Of Funding	1,336,640	1,198,167	138,473
7/1/87	CAS Pension Costs	2,784,691	2,496,204	288,487
7/1/87	Absorbed Credit	0	0	0
7/1/87	CAS Funding Target	2,784,691	2,496,204	288,487
7/1/87	Percentage Funded		48.00%	48.00%
7/1/87	Funded Pension Cost		1,198,167	138,473
	Allowable Interest		53,123	6,139
	Allocable Pension Cost		1,251,290	144,612
	Fiscal Year Pension Cost		2,073,760	201,936
	Medicare LOB Percentage		5.50%	85.97%
	Allowable Pension Cost	$287,661	$114,057	$173,604

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Date	Description	Total Company	Other Segment	Medicare Segment
1988	Contributions	$0	$0	$0
	Discount For Interest	0	0	0
7/1/88	Present Value Contributions	0	0	0
7/1/88	Prepayment Credit	0	0	0
7/1/88	Present Value Of Funding	0	0	0
7/1/88	CAS Pension Costs	2,213,352	1,882,786	330,566
7/1/88	Absorbed Credit	0	0	0
7/1/88	CAS Funding Target	2,213,352	1,882,786	330,566
7/1/88	Percentage Funded		0.00%	0.00%
7/1/88	Funded Pension Cost		0	0
	Allowable Interest		0	0
	Allocable Pension Cost		0	0
	Fiscal Year Pension Cost		938,468	108,459
	Medicare LOB Percentage		5.58%	92.16%
	Allowable Pension Cost	$152,322	$52,366	$99,956

1989	Contributions	$1,945,813	$1,657,556	$288,257
	Discount For Interest	(144,134)	(122,782)	(21,352)
7/1/89	Present Value Contributions	1,801,679	1,534,774	266,905
7/1/89	Prepayment Credit	0	0	0
7/1/89	Present Value Of Funding	1,801,679	1,534,774	266,905
7/1/89	CAS Pension Costs	1,985,756	1,691,582	294,174
7/1/89	Absorbed Credit	0	0	0
7/1/89	CAS Funding Target	1,985,756	1,691,582	294,174
7/1/89	Percentage Funded		90.73%	90.73%
7/1/89	Funded Pension Cost		1,534,774	266,905
	Allowable Interest		86,971	15,125
	Allocable Pension Cost		1,621,745	282,030
	Fiscal Year Pension Cost		405,436	70,508
	Medicare LOB Percentage		5.31%	80.05%
	Allowable Pension Cost	$77,970	$21,529	$56,441

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Date	Description	Total Company	Other Segment	Medicare Segment
1990	Contributions	$0	$0	$0
	Discount For Interest	0	0	0
7/1/90	Present Value Contributions	0	0	0
7/1/90	Prepayment Credit	0	0	0
7/1/90	Present Value Of Funding	0	0	0
7/1/90	CAS Pension Costs	2,071,411	1,897,698	173,713
7/1/90	Absorbed Credit	0	0	0
7/1/90	CAS Funding Target	2,071,411	1,897,698	173,713
7/1/90	Percentage Funded		0.00%	0.00%
7/1/90	Funded Pension Cost		0	0
	Allowable Interest		0	0
	Allocable Pension Cost		0	0
	Fiscal Year Pension Cost		1,216,309	211,523
	Medicare LOB Percentage		6.14%	95.11%
	Allowable Pension Cost	$275,860	$74,681	$201,179

1991	Contributions	$1,148,020	$1,065,355	$82,665
	Discount For Interest	(39,500)	(36,656)	(2,844)
7/1/91	Present Value Contributions	1,108,520	1,028,699	79,821
7/1/91	Prepayment Credit	0	0	0
7/1/91	Present Value Of Funding	1,108,520	1,028,699	79,821
7/1/91	CAS Pension Costs	2,310,380	2,144,019	166,361
7/1/91	Absorbed Credit	0	0	0
7/1/91	CAS Funding Target	2,310,380	2,144,019	166,361
7/1/91	Percentage Funded		47.98%	47.98%
7/1/91	Funded Pension Cost		1,028,699	79,821
	Allowable Interest		36,656	2,844
	Allocable Pension Cost		1,065,355	82,665
	Fiscal Year Pension Cost		266,339	20,666
	Medicare LOB Percentage		4.89%	91.70%
	Allowable Pension Cost	$31,975	$13,024	$18,951

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Date	Description	Total Company	Other Segment	Medicare Segment
1992	Contributions	$3,461,984	$3,308,701	$153,283
	Discount For Interest	(162,354)	(155,166)	(7,188)
7/1/92	Present Value Contributions	3,299,630	3,153,535	146,095
7/1/92	Prepayment Credit	0	0	0
7/1/92	Present Value Of Funding	3,299,630	3,153,535	146,095
7/1/92	CAS Pension Costs	3,022,517	2,876,423	146,094
7/1/92	Absorbed Credit	0	0	0
7/1/92	CAS Funding Target	3,022,517	2,876,423	146,094
7/1/92	Percentage Funded		100.00%	100.00%
7/1/92	Funded Pension Cost		2,876,423	146,094
	Allowable Interest		141,531	7,188
	Allocable Pension Cost		3,017,954	153,282
	Fiscal Year Pension Cost		1,553,505	100,319
	Medicare LOB Percentage		5.95%	97.31%
	Allowable Pension Cost	$190,055	$92,434	$97,621

1993	Contributions	$1,700,000	$1,648,555	$51,445
	Discount For Interest	(37,601)	(36,463)	(1,138)
7/1/93	Present Value Contributions	1,662,399	1,612,092	50,307
7/1/93	Prepayment Credit	299,282	290,225	9,057
7/1/93	Present Value Of Funding	1,961,681	1,902,317	59,364
7/1/93	CAS Pension Costs	3,463,252	3,358,448	104,804
7/1/93	Absorbed Credit	0	0	0
7/1/93	CAS Funding Target	3,463,252	3,358,448	104,804
7/1/93	Percentage Funded		56.64%	56.64%
7/1/93	Funded Pension Cost		1,902,317	59,364
	Allowable Interest		36,463	1,138
	Allocable Pension Cost		1,938,780	60,502
	Fiscal Year Pension Cost		2,748,161	130,087
	Medicare LOB Percentage		4.61%	93.41%
	Allowable Pension Cost	$248,204	$126,690	$121,514

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Date	Description	Total Company	Other Segment	Medicare Segment
1994	Contributions	$2,990,002	$2,955,846	$34,156
	Discount For Interest	(111,608)	(110,333)	(1,275)
7/1/94	Present Value Contributions	2,878,394	2,845,513	32,881
7/1/94	Prepayment Credit	0	0	0
7/1/94	Present Value Of Funding	2,878,394	2,845,513	32,881
7/1/94	CAS Pension Costs	1,844,153	1,811,272	32,881
7/1/94	Absorbed Credit	0	0	0
7/1/94	CAS Funding Target	1,844,153	1,811,272	32,881
7/1/94	Percentage Funded		100.00%	100.00%
7/1/94	Funded Pension Cost		1,811,272	32,881
	Allowable Interest		66,413	1,206
	Allocable Pension Cost		1,877,685	34,087
	Fiscal Year Pension Cost		2,392,928	62,420
	Medicare LOB Percentage		2.35%	95.76%
	Allowable Pension Cost	$116,007	$56,234	$59,773

1995	Contributions	$8,402,834	$8,226,526	$176,308
	Discount For Interest	(548,052)	(536,553)	(11,499)
1/1/95	Present Value Contributions	7,854,782	7,689,973	164,809
1/1/95	Prepayment Credit	1,075,611	1,036,911	38,700
1/1/95	Present Value Of Funding	8,930,393	8,726,884	203,509
1/1/95	CAS Pension Costs	5,656,180	5,452,671	203,509
1/1/95	Absorbed Credit	0	0	0
1/1/95	CAS Funding Target	5,656,180	5,452,671	203,509
1/1/95	Percentage Funded		100.00%	100.00%
1/1/95	Funded Pension Cost		5,452,671	203,509
	Allowable Interest		250,226	9,339
	Allocable Pension Cost		5,702,897	212,848
	Fiscal Year Pension Cost		5,216,015	176,680
	Medicare LOB Percentage		2.72%	98.41%
	Allowable Pension Cost	$315,746	$141,876	$173,870

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Date	Description	Total Company	Other Segment	Medicare Segment
1996	Contributions	$452,747	$435,745	$17,002
	Discount For Interest	(33,537)	(32,278)	(1,259)
1/1/96	Present Value Contributions	419,210	403,467	15,743
1/1/96	Prepayment Credit	3,536,150	3,403,355	132,795
1/1/96	Present Value Of Funding	3,955,360	3,806,822	148,538
1/1/96	CAS Funding Target	3,955,360	3,806,822	148,538
1/1/96	Percentage Funded		100.00%	100.00%
1/1/96	Funded Pension Cost		3,806,822	148,538
	Allowable Interest		22,863	892
	Allocable Pension Cost		3,829,685	149,430
	Fiscal Year Pension Cost		4,297,988	165,285
	Medicare LOB Percentage		2.44%	99.58%
	Allowable Pension Cost	$269,461	$104,871	$164,590

1997	Contributions	$10,011,273	$10,011,273	$0
	Discount For Interest	(741,576)	(741,576)	0
1/1/97	Present Value Contributions	9,269,697	9,269,697	0
1/1/97	Prepayment Credit	0	0	0
1/1/97	Present Value Of Funding	9,269,697	9,269,697	0
1/1/97	CAS Funding Target	9,156,281	9,156,281	0
1/1/97	Percentage Funded		100.00%	0.00%
1/1/97	Funded Pension Cost		9,156,281	0
	Allowable Interest		518,856	0
	Allocable Pension Cost		9,675,137	0
	Fiscal Year Pension Cost		8,213,774	37,358
	Medicare LOB Percentage		1.81%	99.22%
	Allowable Pension Cost	$185,735	$148,669	$37,066

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FOOTNOTES

1/ We obtained total company contribution amounts and dates of deposit from DOL/IRS 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.

2/ We subtracted interest that is included in the contributions deposited after January 1 of each 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 the actual contribution amounts.

3/ The present value of contributions is the value of the contributions discounted from the date of deposit back to January 1. 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.

4/ We applied the prepayment credit towards the funding of the CAS pension costs. Prepayment credits are created when contributions, plus interest, exceed the end-of-year CAS funding target. Prepayment credits may be carried forward, with interest, to fund future CAS pension costs. The prepayment credits are reimbursable for the plan year in which they are used to fund the 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 January 1 of each year.

6/ The CAS pension costs represent the sum of the amortization payment and the normal cost. We separately computed CAS pension costs for plan years 1986 through 1997.

7/ The absorbed credit represents the portion of the accumulated unabsorbed credit that is used to fund the current year CAS pension cost. The credit is used first to fund the CAS pension cost before any current or prepaid contributions are considered for funding.

8/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of FAR 31.205-6(j)(3)(I).

9/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Since any funding in excess of the CAS funding target is considered premature funding in accordance with CAS 412.50(a)(7), we determined that the funded ratio may not exceed 100 percent. We computed the

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FOR FISCAL YEARS 1987 THROUGH 1999

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.

10/ We computed the funded CAS pension cost as the CAS funding target multiplied by the percent funded.

11/ We assumed interest on the funded CAS pension cost is to accrue in the same proportion as the interest on contributions bears to the present value of funding. However, we limited interest by FAR 31.205-6(j)(3)(iii) which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target were funded in four equal installments deposited within 30 days of the end of the quarter.

12/ The allocable CAS pension cost is the amount of pension cost that may be allocated for contract cost purposes.

13/ We converted the plan year allowable CAS pension costs to a fiscal year basis (October 1 through September 30). IBC's original plan year spanned from July 1 through June 30. We calculated the fiscal year pension costs for 1987 through 1994 by multiplying 3/4 of the current plan year's pension costs plus 1/4 of the of the next plan year's costs. Fiscal year 1994 resulted in a shortened plan year due to IBC revising its plan year to coincide with the calendar year. For all remaining years, we calculated the fiscal year pension costs as 1/4 of the prior year's costs plus 3/4 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.

14/ We calculated allowable pension costs of the Medicare and other segments based on the Medicare line of business (LOB) percentage of each segment. We obtained the percentages from documents provided by IBC.

15/ We computed the Medicare pension cost as the Fiscal Year pension cost multiplied by the Medicare LOB percentage.

16/ Subsequent to the issuance of the draft report, we discovered that the actuarial accrued liability for inactive participants had inadvertently been omitted from our CAS pension cost calculations. We added the inactive participants and recomputed the Medicare segment's CAS pension costs. This revision increased the allowable CAS pension costs from $1,762,456 to $2,150,995.

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November 8, 2001

BY FACSIMILE AND FEDERAL EXPRESS

James P. Aasmundstad
Regional Inspector General for Audit Services, Region VII
Department of Health and Human Services
Office of Inspector General
Office of Audit Services
601 East 12th Street
Room 284A
Kansas City, MO 64106

Re: Draft Audit Report Concerning Independence Blue Cross; CIN Nos. A-07-01-00132 and A-07-01-03003

Dear Mr. Aasmundstad:

Independence Blue Cross ("IBC"), through its undersigned counsel, hereby responds to the referenced draft Audit Reports. IBC appreciates the opportunity to respond. We also appreciate the additional information your Office has provided since issuing the draft Reports.

We have reviewed the draft Audit Reports and the additional information your Office has provided. After reviewing this information, IBC sees no basis to depart from the calculations it provided to your Office in September 1999, including the initial asset fraction calculation, the asset "roll-up," and the funded status as of September 30, 1997. Therefore, to the extent there are differences between those calculations and information in the draft Reports, IBC disagrees with those aspects of the draft Reports. Also, as discussed below, IBC disagrees with certain fundamental aspects of the draft Reports that likely impact all or many of the calculations in those Reports.[1]

As you know, IBC has previously provided your Office with substantial amounts of data relating to IBC's pension plan. However, if this response raises further questions, please do not hesitate to contact me. Also, as you will see below, IBC cannot discern the basis for certain aspects of the draft Reports, and we would be interested in discussing these items further with your Office. IBC would like to maintain a dialogue with your Office concerning the issues covered by these Reports, including attempting to resolve informally all open issues.

We first address Draft Audit Report A-07-01-00132, "Audit of the Pension Plan at a Terminated Medicare Contractor" ("Termination Report"), before turning to Draft Audit Report A-07-01-03003, "Review of Pension Costs Claimed for Medicare Reimbursement" ("Pension Cost Report").

I. Termination Report

A. Background

Following the termination of IBC's Medicare Intermediary Contract ("Contract") in 1997, IBC performed certain calculations relating to its pension plan in accordance with Cost Accounting Standard ("CAS") 413 and the Contract. The Contract stated that the "calculation of and accounting for pension costs charged to this agreement/contract are governed by the Federal Acquisition Regulation and [CAS] 412 and 413. The Secretary and the contractor agree that, for purposes of this agreement/contract, CAS 413 shall be interpreted and applied as specified herein." Contract, Appendix B, § XVI.A. CAS 413.50(c)(12) states in part:

> 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 accrued 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.

1 This response does not specifically address every detail in the draft Audit Reports, and this fact should not be construed as an acceptance of any part of the Reports or a waiver of any IBC right(s). IBC reserves all rights with respect to the draft Audit Reports.

Determining the difference between the market value of the assets and the actuarial accrued liability pursuant to CAS 413.50(c)(12) required performing other calculations, including an initial asset allocation. The Contract set forth the methodology for this allocation:

> Pension assets shall be initially allocated and separately identified in accordance with the following procedures:
>
> 1. Date of the initial asset allocation: The initial asset allocation shall be made as of the later of the first day of the first pension plan year following December 31, 1985, or the first day of the first pension plan year following the date on which a Medicare Segment, as defined in Paragraph B, first existed. The date on which the assets are allocated will be referred to as the "allocation date."
>
> 2. Determination of assets allocated to a Medicare Segment: The amount of assets initially allocated to a Medicare Segment shall be determined by multiplying the actuarial value of the undivided pension fund assets on the allocation date by a fraction in which the numerator is the actuarial liability of the segment and the denominator is the actuarial liability of the pension plan as a whole (including the segment). This fraction will be referred to as the "asset fraction."

Contract, Appendix B, § XVI.D. Pursuant to this provision, the date of the initial asset allocation is July 1, 1986. The Contract also specified the date for determining the asset fraction's actuarial liabilities:

> The actuarial liabilities used in the asset fraction will be the actuarial liabilities, as of the later of the first day of the first pension plan year following December 31, 1980, or the first day of the first pension plan year following the date such Medicare Segment first existed, determined under an immediate-gain actuarial cost method consistent with the cost method which was used to fund the pension plan, as of the date for which the asset fraction is being determined.

Contract, Appendix B, § XVI.D.3. The appropriate date for determining the asset fraction liabilities is July 1, 1981.

The Contract included a provision for determining segment assets following the initial asset allocation (also known as the asset "roll-up"): "For each pension plan year following the initial asset allocation required by this Item XVI, the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7)." *Id.*, Appendix B, § XVI.D.4. CAS 413.50(c)(7) states in part: "After the initial allocation of assets, the contractor shall maintain a record of the portion of subsequent contributions, permitted unfunded accruals, income, benefit payments, and expenses attributable to the segment and paid from the assets of the pension plan . . . ."

After the Contract termination, IBC performed work necessary to calculate the difference between assets and liabilities pursuant to CAS 413.50(c)(12), including identifying the "Medicare segment" and the asset fraction in accordance with the Contract. In correspondence with HCFA in 1989, IBC referred to the Medicare segment as the organizational subdivision known as "Provider Services." Following the termination, IBC reviewed this matter. As discussed in previous correspondence with your Office, IBC found that definition to be problematic because a large number of people who did not perform work on the Medicare Contract were included within the segment. Also, in retrospect, IBC realized that such a broad definition is virtually unworkable for the type of pension calculations required by the Contract. Because it was necessary to recreate the initial asset allocation and the asset roll-up, IBC determined that the use of an appropriate but more manageable Medicare segment was prudent. For purposes of recreating an appropriate segment, and performing an initial asset allocation and a yearly asset roll-up, IBC redefined the 1981 Medicare segment to include a smaller, more appropriate group of participants. As discussed further below, the revised definition strictly complies with the Contract's definition of "Medicare segment."

IBC produced to your Office voluminous data relating to its post-termination efforts in support of the subject audit. This data included results of the calculations performed in accordance with CAS 413.50(c)(12) and the Contract. In September 1999, IBC forwarded to your Office these results. IBC identified the asset fraction as 0.82096%, based on July 1, 1981 segment liability of $162,130 divided by July 1, 1981 plan liability of $19,748,904. IBC also identified the July 1, 1986 actuarial value of the undivided pension fund assets as $27,533,485; this amount multiplied by the asset fraction yields $226,038 – the amount of assets initially allocated to the segment. IBC provided your Office with its "roll-up" of the segment actuarial value of assets from July 1, 1986 to September 30, 1997. Finally, IBC provided the Government with the following calculation, performed pursuant to CAS 413.50(c)(12), reflecting the segment's funded status as of September 30, 1997:

Market Value of Assets	$ 1,094,454
Actuarial Accrued Liability	3,525,418
Funded Status	$(2,430,964).

The Termination Report focuses on IBC's calculations and states that the purpose of the Government's review "was to evaluate [IBC's] compliance with the pension segmentation requirements of its Medicare contract and to determine the excess assets that should be remitted to Medicare as a result of the termination of the Medicare contractual relationship effective

September 30, 1997." Termination Report at 1. The Report disagrees with IBC's calculations, and asserts that IBC's Medicare segment assets exceeded the segment's actuarial accrued liability by $2,496,731. After applying a "Medicare percentage" of 93.58% to this amount, the Report recommends that IBC "[r]efund $2,336,441 of excess Medicare pension assets resulting from the termination of its Medicare contract to the CMS." *Id.* at 9-10.

B. The Asset Fraction

One of the main reasons for the differences between IBC's and the Termination Report's CAS 413.50(c)(12) calculations is the Government's use of a larger asset fraction, which in turn contributed to the Government's use of a larger initial asset base for purposes of updating the Medicare segment assets.[2] We provide an overview of steps involved in determining the asset fraction and initial asset allocation to underscore the fact that these calculations are dictated by the Contract.

First, as discussed above, the Contract provided that the asset fraction consists of (1) a numerator – the actuarial liability of the Medicare segment, and (2) a denominator – the actuarial liability of the pension plan as a whole (including the segment). Contract, Appendix B, § XVI.D.2. Second, the Contract specified the date for determining these two actuarial liabilities, which was July 1, 1981. *See id.*, Appendix B, § XVI.D.3. Third, the Contract required that the initial asset allocation be determined by multiplying the actuarial value of the pension fund assets on the contractually-specified "allocation date" (July 1, 1986) by the asset fraction. *See id.*, Appendix B, § XVI.D.

There are significant differences between IBC's calculations and the calculations in the Termination Report. With respect to the denominator of the asset fraction, the Government actually arrived at a larger figure than IBC – $20,327,543 compared to $19,748,904 – which would result in a *smaller* asset fraction if the numerators were the same. However, the numerators were not the same. IBC calculated the 1981 Medicare segment's actuarial liability to be $162,130, while the Government arrived at a figure of $970,526. Thus, IBC's asset fraction was 0.82096% ($162,130 ÷ $19,748,904) while the Government's fraction was 4.7745% ($970,526 ÷ $20,327,543). Also, the Termination Report applies its fraction to the *market value* of 1986 total Company assets – $33,510,864 – yet the Contract required multiplying the fraction and the *actuarial value* of the undivided pension fund assets on the allocation date (July 1, 1986).

[2] The Termination Report recognizes the significance of the parties' different asset fractions, which resulted in different initial asset bases. *See* Termination Report at 5 ("We increased the asset fraction from 0.82096 percent to 4.7745 percent by including the missing participants. Our calculations increased the Medicare segment assets by $1,324,865 to $1,599,976."); *see id.* at 6 ("IBC's methodology in updating the Medicare segment assets from July 1, 1986 to September 30, 1997 resulted in an understatement of Medicare segment assets of $1,788,041. *This understatement primarily occurred because IBC started the update with an understated asset base for 1986.*") (emphasis added).

Contract, Appendix B, § XVI.D.2. As set forth in IBC's September 1999 submission, the 1986 actuarial value of the undivided pension fund assets is $27,533,485. We do not know why the Termination Report used the market value of the 1986 assets.

The results of these calculations are summarized below (this format is similar to the comparison at page 5 of the Termination Report, except that the Report substitutes the market value of the 1986 assets for the actuarial value of those assets in IBC's calculation):

	1981 Total Actuarial Liability (A)	1981 Medicare Actuarial Liability (B)	1981 Rounded Asset Fraction (C)=(B)/(A)	1986 Total Company Assets (D)	1986 Medicare Segment Assets (E)=(C)(D)
OIG Calculation	$20,327,543	$970,526	4.7745%	$33,510,864	$1,599,976
IBC Calculation	$19,748,904	$162,130	0.82096%	$27,533,485	$226,038

The different numerators (1981 segment liability) are the primary reason for the different initial asset allocations, and ultimately the different assets used in the CAS 413.50(c)(12) calculation. The parties arrived at different numerators because they disagree on what constitutes IBC's Medicare segment in 1981. We explain below (at § E) why IBC's determination of the Medicare segment complies with the Contract and should be used in the specified calculations.

C. Asset "Roll-Up"

As noted above, the Contract required that the asset roll-up be performed, for each year after the initial allocation, in accordance with CAS 413.50(c)(7). IBC's roll-up was performed in accordance with CAS 413.50(c)(7). The roll-up also was performed based on IBC's definition of the Medicare segment (discussed further below), which strictly complies with the Contract. In September 1999, IBC provided your Office with the roll-up of the Medicare segment's actuarial value of assets from July 1, 1986 to September 30, 1997. IBC's roll-up established that the actuarial value of the assets as of September 30, 1997 was $954,780. As noted in IBC's September 1999 submission, the market value of the segment assets was determined by multiplying the market value of total plan assets on September 30, 1997 by the ratio of the actuarial value of the segment assets as of September 30, 1997 to the actuarial value of the total plan assets on September 30, 1997. The specific numbers used for this calculation are:

$$\$105{,}272{,}332 \times \frac{954{,}780}{91{,}837{,}472} = \$1{,}094{,}454.$$

The Termination Report contains information concerning the Government's asset roll-up, and states: "Our calculation showed that assets of the Medicare segment increased $3,112,906 to

$4,067,686 as of September 30, 1997." Termination Report at 9. The difference between the Government's asset roll-up and IBC's roll-up results primarily from the parties' different initial asset allocations. Also, we assume that the Government relied on some definition of the Medicare segment to identify participants for purposes of performing its asset roll-up. Unfortunately, as discussed further below, the Report does not identify the Government's interpretation of the Contract segment definition or how the Government applied that definition to IBC. Furthermore, the workpapers and other documents produced by your Office do not discuss the Government's interpretation or application of the Contract's segment definition.[3]

D. Actuarial Accrued Liability as of September 30, 1997

IBC provided your Office with the segment's actuarial accrued liability as of September 30, 1997 – $3,525,418 – as well as supporting details, with its September 1999 submission. In order to identify properly the actuarial accrued liability, IBC identified the Medicare segment for the years 1986 through 1997. IBC identified the segment in accordance with its definition of the Medicare segment (discussed further below), which strictly complies with the Contract.

With respect to accrued liability, the Termination Report states simply: "We computed the Medicare actuarial accrued liability for accrued benefits to be $1,570,955." Termination Report at 9. Information provided by your Office indicates that the difference in the parties' respective accrued liability figures results from identifying different segment populations as of September 30, 1997. Presumably, the Government relied on a definition of the Medicare segment to identify participants for purposes of calculating liability as of September 30, 1997, but the Termination Report and the information provided by your Office do not identify the Government's interpretation of the Contract segment definition or how the Government applied that definition to IBC.

E. The Medicare Segment

The calculations in IBC's September 1999 submission to your Office were performed in accordance with the Contract and applicable CAS requirements. These calculations required

[3] The Termination Report indicates that "IBC's methodology in updating the Medicare segment assets . . . resulted in an understatement of Medicare segment assets of $1,788,041." Termination Report at 6. We are unable to determine the source for the $1,788,041 figure. Also, we should note that the $3,112,906 figure identified at page 6 of the Report ("[w]hen considered with the 1986 adjustment, IBC understated Medicare pension assets by $3,112,906") appears to be the difference between the Government's *market value* of assets as of September 30, 1997 ($4,067,686) and IBC's *actuarial value* of assets as of that date ($954,780). *See* Termination Report, Appendix A at p. 3 of 5.

identifying the Medicare segment.[4] The parties' different determinations of the segment account in large part for their different CAS 413.50(c)(12) calculations. As discussed further below, we cannot discern the basis for the Government's identification of the segment, while IBC's segment determination complies strictly with the Contract and should be used to perform the required calculations.

1. The Contract Definition

The determination of what constitutes the Medicare segment is dictated by the following definition of "Medicare segment" in the Contract:

> The term "Medicare segment" shall mean any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:
>
> 1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or
>
> 2. Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract.
>
> In those cases in which a Medicare Segment as defined in this paragraph B includes both Medicare and non-Medicare activities, the contractor may, but is not required to, treat just the Medicare portion of the segment as a Medicare Segment for purposes of the calculations described in this Item XVI.
>
> Other organizational components identifiable with purposes common to both the Medicare agreement/contract and the contractor's other lines of business will continue to have pension costs indirectly allocated to the Medicare agreement/contract.

Contract, Appendix B, § XVI.B.

[4] The Termination Report acknowledges the importance of the "segment" to the required calculations: "To determine Medicare's share, it was necessary to (1) establish the Medicare *segment's* initial pension assets as of July 1, 1986, (2) update the *segment* assets to September 30, 1997, and (3) calculate the actuarial accrued liability for accrued benefits for the *segment*, and the excess Medicare assets." Termination Report at 4 (emphasis added).

2. IBC's Segment Identification Complies With The Contract

IBC's identification of the Medicare segment clearly complies with the Contract definition. IBC identified the segment as any cost center for which more than 50% of the cost center's salary costs were attributable to the Medicare Contract. There should be little debate that a cost center is an "organizational component," and that identifying more than 50% of the salary costs attributable to the Contract is the same as "the majority of the salary dollars . . . allocated to the Medicare agreement/contract." As such, IBC's identification of the Medicare segment complies with the Contract.

In addition, IBC properly identified the cost centers in 1981 for purposes of calculating the asset fraction. As discussed in previous correspondence with your Office, the three cost centers in 1981 were: 66223 (Medicare I), 77500 (Medicare Coordinator), and 77202 (Provider Audit – Medicare). IBC has previously provided your Office with a 1981 Final Administrative Cost Proposal ("FACP") containing details that support this identification. IBC understands that the Government has audited and approved this FACP. The Termination Report does not mention this FACP.

3. The Termination Report Does Not Identify The Government's Interpretation, How The Government Applied That Interpretation To IBC, Or Why IBC's Determination Does Not Comply With The Contract

The Termination Report does not attempt to explain why IBC's definition of "Medicare segment" fails to comply with the Contract. Moreover, the Report appears to apply a different interpretation of "Medicare segment" without specifically identifying this interpretation. For example, with respect to the asset fraction calculation, the Report states:

> IBC omitted certain cost centers from its 1981 asset fraction calculation. However, IBC included these same cost centers in its identification of the Medicare segment for 1986. *We determined that these cost centers, containing 73 participants, met the contractual specifications for a segment* and included the cost centers in our asset fraction calculation.

Termination Report at 5 (emphasis added). While the Report reflects the Government's *conclusion* that additional cost centers met the Contract's definition, it does not explain *how* the Government reached that conclusion. In particular, the Report does not explain how the Government interpreted the Contract, how the Government applied that interpretation to specific cost centers, how that interpretation differs from IBC's definition, or why the Government's identification of the segment should be substituted for *IBC's* definition of an *IBC* segment.

The Report suggests that IBC's identification of the 1981 segment for purposes of determining the asset fraction is somehow affected by the inclusion of additional cost centers in a *1986* identification of the segment. However, the 1986 segment is irrelevant to identifying the

1981 segment for purposes of determining the asset fraction. The Contract required that the segment's liabilities be identified in *1981*. As such, the status of the segment five years later plays no role under the Contract in calculating the asset fraction.

As with the asset fraction, the Termination Report refers to the "segment" in addressing other parts of the required calculations but does not identify how the Government interpreted and applied the Contract's segment definition. Examples of such references in the Report include:

- "Due to the incorrect identification of the Medicare segment participants, IBC's update of the segment assets did not properly identify benefit payments to retirees that were segment participants. We identified the actual benefits paid to the retirees from the Medicare segment and assigned these costs to the Medicare segment." Termination Report at 6.

- "In the update of pension assets, IBC misidentified Medicare segment participants. . . . We corrected the identification of the segment participants and transfer amounts in updating the Medicare segment pension assets . . . ." *Id.* at 7.

After reviewing the Termination Report, we asked your Office for information relating to the Government's segment identification. Initially, we asked for "all information relating to the conclusion in the report that [IBC] omitted 8 Medicare cost centers (containing 73 participants) from the Medicare segment, including all information concerning the identities of the 8 cost centers, as well as the 73 participants, *and the basis for the conclusion.*" (Emphasis added). We also asked for copies of all worksheets supporting numbers and calculations in the Report. In response to these requests, your Office provided a CD containing various documents, including information concerning cost centers (*e.g.* Government "crosswalks"), but no narrative explanation of how the Government interpreted the Contract's definition of "Medicare segment," and no explanation of the basis for the Government's conclusion that eight additional cost centers met that definition.

As such, we again sought information underlying the Termination Report's comments concerning the Medicare segment. In an October 12, 2001 letter, we asked for a description of "how your Office applied the Medicare segment definition from the Medicare contracts . . . to IBC in determining that additional cost centers met this definition for purposes of the 1981 asset fraction calculation." In response, your Office did not describe how it applied the Contract segment definition to IBC, but instead referred to certain documents: "See copy of FAX addressed to Ron Solomon from IBC, file on CD titled 'Interview with 1981 Staff', file on CD titled 'Meeting with IBC Controller', file on CD titled 'IBC's Crosswalk', and Scope section of our audit report." In our October 12 letter, we also asked for a description of how your Office "applied the Medicare segment definition from the Medicare contracts to IBC in determining that additional cost centers met this definition for 1986 and later years (including determinations concerning transfers into and out of the segment)." In response, your Office did not provide the requested description, but again referred to certain documents – two "crosswalks" and the "FAX addressed to Ron Solomon from IBC." Unfortunately, none of these documents describes the Government's interpretation of the Contract definition, the application of that interpretation to IBC, or the basis for any Government disagreement with IBC's identification of the 1981 segment.

The only document identified that provides any insight into *how* the Government selected additional cost centers is a Government summary of a January 24, 2000 meeting with IBC representatives (entitled "Meeting With Controller"). This document includes the following comment by a Government representative:

> We don't agree that your asset fraction is in compliance with the contract. We followed the methodology that we've been using since the very first Medicare segmentation audit in identifying the 1981 Medicare segment. We started with 1988 and traced the segment's lineage back to 1986 and then to 1981. Using this methodology we identified 10 cost centers that should have been included in the asset fraction. [Showed IBC personnel our cross walk of Medicare segment cost centers]. Using this identification of the Medicare segment, we computed an asset fraction of 4.9%.

While this comment mentions a "methodology" that apparently involves tracing the segment's lineage from 1988 to 1981, it does not explain that methodology further, nor does it explain how that methodology complies with the Contract. In particular, it does not explain how the status of the segment in 1986 or 1988 is relevant given the Contract's mandate to focus solely on the segment in 1981 for purposes of the asset fraction. Also, while the referenced excerpt states that the Government did not agree that IBC's asset fraction complies with the Contract, it does not explain the basis for that conclusion or why the Government's segment identification should be substituted for IBC's definition of an IBC segment.

The "Meeting With Controller" document also suggests that the Government may perceive certain "inequities" in IBC's calculation of the asset fraction. In particular, the document includes the following Government comments:

- "In 1986 you had a segment of 118 participants with AAL of about $2.1 million, yet your revised asset fraction was based on only 20 participants in 2 cost centers, resulting in segment assets of only $226,038. Does this seem equitable to you?"

- "This revised asset fraction when applied to total company assets as of 7/1/86 resulted in Medicare segment assets of $226,038. Under IBC's revised computations, the Medicare segment's funding level was only

> 11% as compared to a total company funding level of 64%. Clearly not an equitable distribution of funding."[5]

To the extent these comments reflect current Government concerns, we should note that they are not relevant to the determination of the asset fraction. As discussed above, the Contract clearly required calculation of the Medicare segment liabilities in 1981, and therefore the status of the segment in 1986 is not part of the required equation. Similarly, a comparison of the segment's funding level to the total company funding level is simply not part of the Contract's formula. The Contract sets forth a straightforward method for determining initial segment assets, and there is no basis for altering that method. Indeed, we should note that the Government drafted the provisions requiring the determination of assets; IBC simply followed the method set forth in these provisions.

IBC's determination of the Medicare segment complies with the Contract and should be used to perform the required calculations. The Termination Report offers no reason why IBC's determination does *not* comply with the Contract. Instead, the Report concludes that certain omitted cost centers met the Contract's segment definition, but fails to explain this conclusion. Yet even assuming the Report had explained how the Government's segment determination complies with the Contract, that would not justify supplanting IBC's compliant determination. Designating what constitutes a "segment" under CAS 413 generally is the responsibility of the contractor. *See* 1 Lane K. Anderson, *Accounting for Government Contracts: Cost Accounting Standards* § 22.05[1] (2001) ("The contractor is responsible for designating organizational units as segments, in accordance with the requirements of CAS 403.").

II. Pension Cost Report

A. Background

In conjunction with the termination audit, your Office conducted an audit to determine the allowability of pension costs claimed for FYs 1987 through 1997. Pension Cost Report at 2. Your Office concluded that IBC "under claimed allowable Medicare pension costs" in the amount of $711,444. *Id.* at 1. The Report states that the "under claim of pension costs primarily occurred because IBC neglected to include certain pension contribution amounts on their [FACPs]." *Id.* The Report further states:

> IBC assigned pension costs to Medicare based upon an allocation of actual contributions to its pension trust fund. However, IBC only included an

[5] The "Meeting With Controller" document attributes statements and actions to IBC representatives. IBC does not necessarily agree with these statements/actions, and reserves the right to address further the contents of this document.

> allocable portion of the contributions that were actually deposited at the time the FACPs were filed each year. Consequently, IBC did not claim Medicare reimbursement for any portion of the pension contributions that were deposited after the FACPs were filed. Additionally, due to budget constraints, IBC did not file supplemental or amended FACPs to include the additional pension contributions made after the original filings.

Id. at 3.

As with the Termination Report, the Pension Cost Report appears to rest substantially on the Government's identification of the Medicare segment: "We calculated the allowable CAS pension costs *for the Medicare segment* and for Medicare indirect operations. The calculations were based on separately computed CAS pension costs *for the Medicare segment* and total company CAS pension costs." *Id.* (emphasis added). However, as discussed below, the Pension Cost Report does not identify *how* the Government interpreted the Contract's segment definition or applied that interpretation to IBC in determining allowable costs.

B. The Government's Conclusions Appear To Be Based On An Unidentified Interpretation Of The Contract's Segment Definition

After receiving the Pension Cost Report, we asked your Office (in our August 29 letter) for "[c]opies of all worksheets that support the numbers and calculations in the [Termination and Pension Cost] reports . . . ." We have reviewed the information produced, but cannot discern which specific contributions the Government believes IBC did not claim "that were deposited after the FACPs were filed."

More importantly, we cannot discern how the Government interpreted the Contract segment definition and applied that interpretation to IBC. As noted earlier, it appears that the Government's identification of the segment is an important factor in the Pension Cost Report's conclusions. We suspect that the Government's segment identification was substantially the same as the identification used in the Termination Report. Indeed, we suspect that the Government's redetermination of IBC's segment identification used in performing the required termination calculations likely led to and significantly influenced the Government's separate pension cost calculations. However, we cannot confirm the details underlying the Government's pension cost calculations.

To the extent that IBC did not claim Medicare reimbursement for pension contributions that were deposited after IBC filed its FACPs, and those costs are allowable under IBC's identification of the Medicare segment, IBC agrees that such costs would be reimbursable. However, to the extent the Government arrived at any portion of the allowable costs in the Pension Cost Report based on a different identification of the segment, IBC reserves the right to contest the Report's conclusions. As stated in response to the Termination Report, IBC's determination of the segment complies with the Contract and should be used to perform the required calculations. Neither the Termination Report nor the Pension Cost Report offers any reason why IBC's determination does *not* comply with the Contract, and neither explains how the Government interpreted the Contract definition or applied that interpretation to IBC.

III. Conclusion

Let me reiterate our appreciation of the information provided by your Office in connection with the Audit Reports. Based on the Reports and supporting data, the definition of "Medicare segment" appears to influence significantly the Government's conclusions and also appears to be the primary difference between the parties. IBC believes that its identification of the segment strictly complies with the Contract and should be used in performing the required calculations and determining allowable costs. We cannot discern the basis for Government's segment identification, but would be willing to discuss this matter further with your Office. As I mentioned earlier, IBC is interested in maintaining a dialogue with your Office and attempting to resolve informally all open issues.

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

Sincerely,

Marcia G. Madsen

Marcia G. Madsen

cc: Greg Tambke
Eleanor Thompson

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M E M O R A N D U M

To: Greg Tambke, Audit Manager
HHS/OIG/OAS, Jefferson City, Missouri

From: Ron Solomon

Date: November 19, 2001

Subject: Analysis of Segment Identification by Independence Blue Cross (IBC)

This memorandum reviews the segment identification issues raised in the 14 page response submitted by IBC to the two pension draft audit reports (CIN A-07-01-00132 Audit of the Pension Plan at a Terminated Medicare Contractor Independence Blue Cross and CIN A-07-01-03003 Review of Pension Costs Claimed for Medicare Reimbursement by Independence Blue Cross) via counsel on November 8, 2001. Notwithstanding the detailed reasons for the recommendations set forth in the reports, IBC essentially disagrees with any finding that is not consistent with the calculations it provided to the auditors in September, 1999. In the response, IBC states that it "disagrees with certain fundamental aspects of the draft Reports that likely impact all or many of the calculations in those Reports." Those fundamental aspects are the identification of the Medicare segment in accordance with the contract, and the subsequent determination of the asset fraction and the initial allocation of assets to the segment. Even though IBC recognizes the fundamental nature of the segment identification[1], it does not get around to a discussion of this issue until Section I.E, beginning on page 7.

IBC uses virtually all of page 8 of its response to quote the Medicare contract, Appendix B, §XVI.B, regarding the determination of the Medicare segment. Appendix B §XVI was added to the Medicare contract effective October 1, 1987 following extensive negotiations[2]. As of that time each contractor was required to identify its Medicare segment(s) if any ("any organizational component of the contractor…having a significant degree of responsibility and accountability for the Medicare contract/agreement…"). The contractors were all notified by letter in early 1989 of the need to comply with Appendix B §XVI of the contract. The letter,

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[1] In addition to the quote above from the second paragraph of the response, segment identification is referenced in Sections I.A, I.B, I.C, and I.D prior to the discussion in I.E.

[2] IBC incorrectly asserts on page 12 of its response that "the Government drafted the provisions…" In reality, the language of Appendix B §XVI was jointly developed by HCFA and contractor representatives and their attorneys.

which IBC received in April, 1989, was accompanied by a questionnaire which outlined the process contractors were to follow and also specified relevant documentation that was necessary to be maintained by the contractor. IBC responded by letter dated August 30, 1989, identifying its Medicare segment as "Provider Services" which "performs all the major Medicare processing activities including: bills payment, appeals, medicare (sic) secondary payer, medical review, audit and provider reimbursement." The letter also stated, "As per your request, documentation supporting all calculations in the questionnaire is on file in our offices and will be periodically updated as new pension related information becomes available."

As noted above, the identification of the Medicare segment is fundamental, because the initial allocation of assets and the determination of the asset fraction are *for the segment*. The contract, which IBC quotes accurately but applies selectively and inaccurately, requires that the initial asset allocation be made to "a Medicare Segment, as defined in Paragraph B" based on a fraction determined for "such Medicare Segment." Thus, it is necessary to take the identified segment as of October 1, 1987 and trace it back to the relevant dates which are, as IBC correctly notes in §I.A of its response, July 1, 1986 and July 1, 1981 respectively. This is what has been done in each and every Medicare contractor pension segmentation audit, and it is what was done in this audit and upon which all calculations are based. It is apparently also what IBC did when responding in 1989.

However IBC completely misapplied the contract language in its 1999 determination and in its current response. Instead of complying with the contractual provisions, IBC wants to define a different segment at each different date. As the response states in §I.A, "Because it was necessary to recreate the initial asset allocation and the asset roll-up, IBC determined that the use of an appropriate but more manageable Medicare segment was prudent. For purposes of recreating an appropriate segment,...IBC *redefined the 1981 Medicare segment* to include a smaller, more appropriate group of participants" (emphasis added). IBC somehow misconstrues the contractual requirement to determine the actuarial liability of the segment in 1981 as requiring a redefinition of the segment in 1981. The response explicitly states this misconception in §I.E.3: "However, the 1986 segment is irrelevant to identifying the 1981 segment for purposes of determining the asset fraction. The Contract required that the segment's liabilities be identified in *1981*" (emphasis in original). Somehow IBC interprets "segment's liabilities be identified" to mean "segment be identified."

IBC in its response even shows that it does not understand the contractual definition of Medicare segment by stating in §I.E.2, "IBC identified the segment as any cost center for which more than 50% of the cost center's salary costs were attributable to the Medicare Contract." Only by ignoring the additional language in the contract quoted above about an organizational component with a significant degree of responsibility and accountability can IBC identify this collection of cost centers as a segment. It is the contractor's prerogative to establish its organizational structure as it sees fit, and that structure determines the segment, in accordance with the Cost Accounting Standards and the contract. This does not mean that the contractor can decide arbitrarily at some later time to designate a few separate cost centers to be a segment[3]. Whether or not a contractor omits the non-Medicare portion of its segment[4], an organizational component constituting a Medicare segment normally does not have 100% of its costs allocated to Medicare. The audit report recommendation reflects the fact that the segment is not 100% Medicare by adjusting the difference between the segment's assets and actuarial liability by the appropriate percentage. The details of this calculation are shown in Appendix B of the report.

To summarize, IBC's response is correct in recognizing that identification of the Medicare segment is fundamental to virtually all of the calculations in the reports. However, IBC's 1999 determination of different Medicare segments at the various dates is not based on contractual provisions, whereas all calculations in the reports are based on the Medicare segment that has been determined in accordance with a strict application of the language in the contract.

Please feel free to contact me at 410-786-6383 or Eric Shipley at 410-786-6381 if you have any questions.

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[3] Indeed, it was made clear during the contract negotiations when the contractor representatives and HCFA reached agreement on the specific language of Appendix B §XVI that the contractors did not want segments to be identified at the cost center level based on the percentage of costs charged to the contract by individual cost centers.

[4] The contract provides that a contractor having a segment with "both Medicare and non-Medicare activities...may, but is not required to, treat just the Medicare portion of the segment as a Medicare Segment..."

<u>Appendix D</u>

AUDIT REPORT CIN: A-07-01-03003
INDEPENDENCE BLUE CROSS

INDIVIDUALS HAVING ACCESS TO SOURCE INFORMATION REGARDING THIS AUDIT REPORT

Greg Tambke, Audit Manager
Scott Englund, Senior Auditor
Dave Imhoff, Auditor
Ann Lowe, Independent Report Reviewer

<u>Class of Persons Having Access To This Report</u>

Office Administrative Personnel