



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

FEB 23 2004

TO: Wynethea Walker
Acting Director, Audit Liaison Staff
Centers for Medicare & Medicaid Services

FROM: Dennis J. Duquette *Duquette*
Deputy Inspector General
for Audit Services

SUBJECT: Audit of the Pension Plan at a Terminated Medicare Contractor, Blue Cross Blue Shield of Connecticut (A-07-02-03021)

We are alerting you to the issuance of the subject report within 5 business days from the date of this memorandum. A copy of this report, identifying over \$1 million in excess pension assets at Blue Cross Blue Shield of Connecticut (Connecticut), is attached. This audit was performed at the request of the Centers for Medicare & Medicaid Services (CMS).

We suggest that you share this report with the CMS components involved with monitoring the Medicare contractors' financial operations, particularly the Office of Financial Management, the Center for Medicare Management, and the Office of the Actuary.

Connecticut was a Medicare contractor until its contract was terminated in 1999 and, as such, was allowed to claim reimbursement for its Medicare employees' pension costs. Federal regulations and the Medicare contracts provide, however, that pension gains which occur when a Medicare segment of a pension plan closes, be credited to the Medicare program. Accordingly, we recommend that Connecticut remit \$1,351,284 in excess pension assets to the Medicare program.

Connecticut agreed with our recommendation.

Please send us your final management decision, including any action plan, as appropriate, within 60 days. If you have any questions or comments about this report, please do not hesitate to call me or have your staff call George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or James P. Aasmundstad, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591. To facilitate identification, please refer to report number A-07-02-03021 in all correspondence.

Attachment



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

FEB 27 2004

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

Report Number: A-07-02-03021

Mr. T. Jeffrey Hannah
Anthem, Inc.
120 Monument Circle
Mail No. M2SG
Indianapolis, Indiana 46204

Dear Mr. Hannah:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) report entitled "Audit of the Pension Plan at a Terminated Medicare Contractor, Blue Cross Blue Shield of Connecticut." A copy of this report will be forwarded to the action official noted below for review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. We request that you respond to the HHS action 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.

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise (see 45 CFR part 5).

To facilitate identification, please refer to report number A-07-02-03021 in all correspondence.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James P. Aasmundstad".

James P. Aasmundstad
Regional Inspector General
for Audit Services

Enclosures - as stated

Page 2 – Mr. T. Jeffrey Hannah

Directly Reply to HHS Action Official:

Charlotte Yeh, MD
Regional Administrator, Region I
Centers for Medicare & Medicaid Services
JFK Federal Building
Room 2325
Boston, Massachusetts 02203

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF THE PENSION PLAN
AT A TERMINATED MEDICARE
CONTRACTOR, BLUE CROSS BLUE
SHIELD OF CONNECTICUT**



**FEBRUARY 2004
A-07-02-03021**

EXECUTIVE SUMMARY

Objectives

The objectives of our review were to (1) evaluate Connecticut's compliance with the pension segmentation requirements of its Medicare contract and (2) determine the excess assets that should be remitted to Medicare as a result of the termination of the Medicare contractual relationship effective June 30, 1999.

Summary of Findings

We determined that Connecticut understated Medicare pension assets as of September 30, 1999 by \$65,091. During this period, we identified Medicare segment assets of \$1,440,938. Connecticut identified Medicare segment assets of \$1,375,847. The \$65,091 increase resulted from an inequitable allocation of investment earnings. We computed excess pension assets, in accordance with Connecticut's Medicare contract and the Cost Accounting Standards (CAS), of \$1,440,938 as of June 30, 1999. We determined that Medicare's share of the excess pension assets was \$1,351,284.

Recommendation

We recommend that Connecticut remit the \$1,351,284 of excess Medicare pension assets resulting from the termination of its Medicare contract to the Federal Government.

Auditee's Comments

Connecticut agreed with our recommendation.

TABLE OF CONTENTS

| | Page |
|-----------------------------------------------------------------------------------|-------------|
| INTRODUCTION | 1 |
| Background | 1 |
| Objectives, Scope, and Methodology | 2 |
| Objectives | 2 |
| Scope | 2 |
| Methodology | 2 |
| FINDINGS AND RECOMMENDATIONS | 3 |
| Update of Medicare Segment Assets From January 1, 1996 Through June 30, 1999 | 3 |
| Criteria | 3 |
| Condition and Cause | 3 |
| Effect | 3 |
| Excess Medicare Pension Assets | 4 |
| Criteria | 4 |
| Condition and Cause | 5 |
| Effect | 5 |
| Recommendation | 5 |
| APPENDICES | |
| A - STATEMENT OF MEDICARE PENSION ASSETS JANUARY 1, 1996 THROUGH JUNE 30, 1999 | |
| B - CALCULATION OF AGGREGATE MEDICARE PERCENTAGE | |
| C – AUDITEES’ COMMENTS | |

INTRODUCTION

BACKGROUND

Medicare

Connecticut administered Medicare Part A under a cost reimbursement contract until the contractual relationship was terminated effective June 30, 1999. In claiming costs, contractors were to follow cost reimbursement principles contained in the Federal Procurement Regulations (FPR), which were superseded by the Federal Acquisition Regulations (FAR), CAS, and the Medicare contracts.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to its pension plans. These payments represented allowable pension costs under FPR and/or FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

The Centers for Medicare & Medicaid Services (CMS) incorporated segmentation requirements into Medicare contracts starting with fiscal year 1988. The contractual language specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment.

The Medicare contract defines a segment, and specifies the methodology for the identification and initial allocation of pension assets to the Medicare segment. Furthermore, the contract requires that the Medicare segment assets be updated for each year after the initial allocation in accordance with CAS 413.

Regulations

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

Connecticut

Connecticut terminated the Medicare segment of its business effective June 30, 1999. The Medicare pension plan participants were transferred to Connecticut's non-Medicare operations at that time.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to (1) evaluate Connecticut's compliance with the pension segmentation requirements of its Medicare contract and (2) determine the excess assets that should be remitted to Medicare as a result of the termination of the Medicare contractual relationship effective June 30, 1999.

Scope

Achieving our objectives did not require a review of Connecticut's internal control structure.

We reviewed Connecticut's identification of the Medicare segment and its update of Medicare assets from January 1, 1996 through June 30, 1999. Connecticut's Medicare contract was terminated and the Medicare segment closed on June 30, 1999. Therefore, we determined that June 30, 1999 would be the appropriate settlement date to measure the segment closing adjustment amount.

Methodology

In performing the review, we used information provided by Connecticut's prior and current consulting actuarial firms. The information included liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed Connecticut's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, CMS pension actuarial staff calculated Medicare segment assets as of June 30, 1999. We reviewed their methodology and calculations.

Details for the updated pension assets of the Medicare segment from January 1, 1996 through June 30, 1999 are presented in Appendix A.

Site work at Connecticut's corporate office in Hartford, Connecticut was performed during April 2003. We performed subsequent audit work in our Office of Inspector General (OIG), Jefferson City, Missouri field office.

Our audit was performed in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

UPDATE OF MEDICARE SEGMENT ASSETS FROM JANUARY 1, 1996 THROUGH JUNE 30, 1999

We updated pension assets of the Medicare segment from January 1, 1994 through June 30, 1999 and determined pension assets were understated by \$65,091. In our opinion, this resulted from revising net segment earnings and expenses (\$65,091 increase).

CRITERIA

Determining segment assets is addressed by the Medicare contract, which states “. . . the pension assets allocated to each Medicare segment shall be adjusted in accordance with CAS 413.50(c)(7).”

Specifically, CAS 413.50(c)(7) provides that the asset base be adjusted by contributions, income, benefit payments, and expenses. In addition, an adjustment should also be made for transfers (participants who enter or leave the segment).

CONDITION AND CAUSE

Earnings and Expenses

Connecticut's allocated earnings and expenses for the Medicare segment were understated by \$65,091. The understatement was primarily due to an inequitable investment allocation for 1998.

Connecticut allocated investment earnings in proportion to the average value of assets. However, the 1998 allocation included (and gave full weight to) a \$30,000,000 contribution receivable that was credited to the Other segment. The contribution receivable should have been given no weight for 1998 since it was not actually deposited until after the end of the 1998 plan year. Connecticut's allocation, therefore, overstated investment earnings to be allocated to the Other segment by \$61,146, and understated the investment earnings allocated to the Medicare segment by the same amount. The adjustment in the 1998 investment allocation also affected the investment allocation for 1999 by \$3,946. Except for the weighting of the contribution receivable for 1998, we used Connecticut's allocation methodology for earnings and expenses in our update. Therefore, we will increase the Medicare segment assets by \$65,091.

EFFECT

Connecticut's update of Medicare segment pension assets from January 1, 1996 through June 30, 1999 understated assets by \$65,091. Therefore, the Medicare segment assets as of June 30, 1999 should have been \$1,440,938.

EXCESS MEDICARE PENSION ASSETS

Connecticut's Medicare contract was terminated effective June 30, 1999. Around that time the Medicare pension plan participants were transferred to the non-Medicare operations. The remaining Medicare segment pension assets as of June 30, 1999 totaled \$1,440,938. However, because the segment was not 100 percent devoted to Medicare operations, only a portion of the excess segment pension assets were attributable to Medicare.

CRITERIA

Medicare contracts specifically prohibit any profit (gain) from Medicare activities. Therefore, according to the contract, pension gains, which occur when a Medicare segment terminates, should be credited to the Medicare program. In addition, FAR addresses dispositions of gains in situations such as contract terminations. When excess or surplus assets revert to a contractor as a result of termination of a defined benefit pension plan or such assets are constructively received by it for any reason, the contractor shall make a refund or give credit to the Government for its equitable share (FAR, section 31.205-6(j)(4)). Contract terminations and segment closings are addressed by CAS at 9904.413-50(c)(12), which states:

If a segment is closed . . . 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.

(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 . . .

(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 . . . 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.

Determining the Federal Government's share of the excess segment 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 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

CONDITION AND CAUSE

At the time the contract was terminated, the Medicare pension assets totaled \$1,440,938. Since at termination the Medicare pension plan participants were transferred to the non-Medicare operations, the excess Medicare pensions assets are \$1,440,938. However, because the segment was not 100 percent devoted to Medicare operations, only a portion of the excess segment assets is attributable to Medicare.

After applying the Medicare percentage to the excess segment assets, the resulting amount of \$1,351,284 represents the portion attributable to Medicare. Because of the termination of the Medicare contract, this excess must be remitted to the Federal Government.

EFFECT

Connecticut maintained excess pension assets for the Medicare segment of \$1,440,938, of which \$1,351,284 represents the Federal Government share.

RECOMMENDATION

We recommend that Connecticut refund \$1,351,284 of excess Medicare pension assets resulting from the termination of its Medicare contract to the Federal Government.

AUDITEE'S COMMENTS

Connecticut agreed with our recommendation; see Appendix C.

APPENDICES

CONNECTICUT
STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1996 THROUGH JUNE 30, 1999

| Date | Description | Total Company | Other Segments | Medicare Segment | FEP/Anthem Segment |
|-----------------------|-------------------------------|--------------------------|---------------------------|-----------------------------|-------------------------------|
| 12/31/1995 | Market Value of Assets | <u>1/</u> \$95,146,501 | \$92,733,953 | \$1,949,983 | \$462,565 |
| | Transfers | <u>2/</u> 0 | (14,053) | (1,059) | 15,112 |
| 1/1/1996 | Market Value of Assets | 95,146,501 | 92,719,900 | 1,948,924 | 477,677 |
| | Prepayment Transfer | <u>3/</u> 0 | (33,493) | 0 | 33,493 |
| | Employer Contribution | <u>4/</u> 8,351,738 | 8,351,738 | 0 | 0 |
| | Other Transactions | 0 | 0 | 0 | 0 |
| 16.35% | Investment Earnings | <u>5/</u> 16,528,236 | 16,160,392 | 291,775 | 76,069 |
| | Benefit Payments | <u>6/</u> (8,884,350) | (8,376,130) | (296,103) | (212,117) |
| | Admin Expenses | <u>7/</u> (690,888) | (675,512) | (12,196) | (3,180) |
| 12/31/1996 | Market Value of Assets | 110,451,237 | 108,146,895 | 1,932,400 | 371,942 |
| | Transfers | 0 | 39,961 | 15,608 | (55,569) |
| 1/1/1997 | Market Value of Assets | 110,451,237 | 108,186,856 | 1,948,008 | 316,373 |
| | Prepayment Transfer | 0 | (4,803) | 0 | 4,803 |
| | Employer Contribution | 8,007,580 | 8,007,580 | 0 | 0 |
| | Other Transactions | 0 | 0 | 0 | 0 |
| 20.66% | Investment Earnings | 24,295,530 | 23,814,932 | 412,407 | 68,191 |
| | Benefit Payments | (6,230,267) | (6,215,873) | (14,394) | 0 |
| | Admin Expenses | (683,541) | (670,019) | (11,603) | (1,919) |
| 12/31/1997 | Market Value of Assets | 135,840,539 | 133,118,673 | 2,334,418 | 387,448 |
| | Transfers | 0 | (1,932) | (25,291) | 27,223 |
| 1/1/1998 | Market Value of Assets | 135,840,539 | 133,116,741 | 2,309,127 | 414,671 |
| | Prepayment Transfer | 0 | (53,463) | 0 | 53,463 |
| | Employer Contribution | 0 | 0 | 0 | 0 |
| | Other Transactions | 0 | 0 | 0 | 0 |
| 13.95% | Investment Earnings | 18,240,771 | 17,840,819 | 332,361 | 67,591 |
| | Benefit Payments | (19,009,998) | (18,995,604) | (14,394) | 0 |
| | Admin Expenses | (610,824) | (597,431) | (11,130) | (2,263) |
| 12/31/1998 | Market Value of Assets | 134,460,488 | 131,311,062 | 2,615,964 | 533,462 |
| | Transfers | 0 | 1,082,426 | (548,964) | (533,462) |
| 1/1/1999 | Market Value of Assets | 134,460,488 | 132,393,488 | 2,067,000 | 0 |
| | Prepayment Transfer | 0 | 0 | 0 | 0 |
| | Employer Contribution | 0 | 0 | 0 | 0 |
| | Other Transactions | 359,744,777 | 0 | 0 | 359,744,777 |
| 6.84% | Investment Earnings | 34,218,580 | 9,489,575 | 148,156 | 24,580,849 |
| | Benefit Payments | (33,611,691) | 0 | 0 | (33,611,691) |
| | Admin Expenses | (1,566,454) | (434,413) | (6,782) | (1,125,259) |
| 6/29/1999 | Market Value of Assets | 493,245,700 | 141,448,650 | 2,208,374 | 349,588,676 |
| | Transfers | 0 | 767,436 | (767,436) | 0 |
| 6/30/1999 | Market Value of Assets | \$493,245,700 | \$142,216,086 | \$1,440,938 | \$349,588,676 |
| 6/30/1999 | Per Connecticut | <u>8/</u> | | 1,375,847 | |
| Asset Variance | <u>9/</u> | | | 65,091 | |

**CONNECTICUT
STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1996 THROUGH JUNE 30, 1999**

FOOTNOTES

1. We determined the Medicare segment assets as of January 1, 1996 in our prior review of Connecticut's pension segmentation (A-07-97-02500). The amounts shown for the other segment represent the difference between the total company, the Medicare, and the Federal Employees Program/Anthem segment. All pension assets are shown at market value.
2. We identified participant transfers between segments by comparing annual participant valuation listings provided by Connecticut. The listings provided the liability of each participant. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. Connecticut adjusted the January 1, 1996 through June 30, 1999 actuarial liability amounts to the Accrued Benefit Cost Method as required by CAS.
3. The prepayment transfer is created when the contributions made to the pension trust fund exceed the CAS pension cost. The prepayment remains unassigned and accumulates interest in the trust fund until needed to fund future CAS pension costs. We allocated the prepayment in proportion to the CAS pension costs.
4. We obtained total company contribution amounts from the actuarial valuation reports. We allocated total company contributions to the Medicare segment based on the total prepayment allowed multiplied by the Medicare segment funding target divided by the total company funding target.
5. We obtained investment earnings from the actuarial valuation reports. Connecticut allocated earnings to each segment based on the average invested assets during the year for each segment. We used the same methodology.
6. We based the Medicare segment's benefit payments on actual benefit payments to Medicare retirees. We found Medicare retirees by comparing the total company valuation listings year-to-year. We created a list of retirees with their benefit payment amounts by year.
7. We calculated the total Medicare segment administrative expenses based on a ratio of segment assets to total company assets.
8. We obtained total asset amounts as of June 30, 1999 from Connecticut's update of Medicare segment assets.

**CONNECTICUT
STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1 , 1986 THROUGH JUNE 30, 1999**

FOOTNOTES

9. The asset variance represents the difference between the OIG calculation of Medicare segment assets as of June 30, 1999 and the segment assets calculated by Connecticut.

APPENDIX B

CALCULATION OF AGGREGATE MEDICARE PERCENTAGE

| | Total Salaries | Medicare Salaries | % Medicare |
|-------|----------------|-------------------|------------|
| 1986 | \$1,461,138 | \$1,416,709 | 96.96% |
| 1987 | 1,405,517 | 1,365,710 | 97.17% |
| 1988 | 1,298,783 | 1,256,262 | 96.73% |
| 1989 | 1,427,217 | 1,350,238 | 94.61% |
| 1990 | 1,442,252 | 1,403,700 | 97.33% |
| 1991 | 1,352,690 | 1,255,742 | 92.83% |
| 1992 | 1,172,547 | 1,107,280 | 94.43% |
| 1993 | 1,182,237 | 1,122,887 | 94.98% |
| 1994 | 781,666 | 557,721 | 71.35% |
| 1995 | 1,661,602 | 1,070,238 | 64.41% |
| 1996 | 2,875,367 | 2,875,367 | 100.00% |
| 1997* | 2,249,023 | 2,249,023 | 100.00% |
| 1998* | 2,249,023 | 2,249,023 | 100.00% |
| Total | \$20,559,062 | \$19,279,900 | 93.78% |

* No information was available for 1998. Connecticut used the 1997 salary information to allocate pension costs for Medicare reimbursement in 1998.

T. Jeffrey Hannah
Senior Counsel

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Appendix C

December 12, 2003

Anthem 

Mr. Scott Englund
Office of Inspector General
Office of Audit Services
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Re: Audit of the Pension Plan at a Terminated Medicare Contractor,
Blue Cross Blue Shield of Connecticut

Dear Scott:

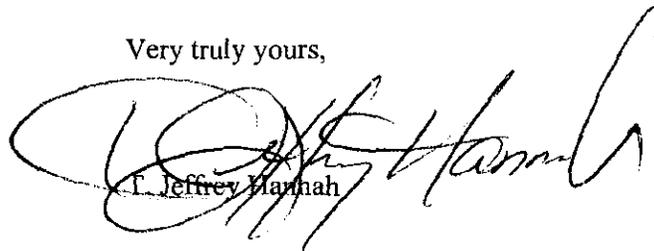
I write to follow up our conversations regarding the Draft Audit Report, forwarded to me by letter dated October 27, 2003, relating to the determination of excess assets that should be remitted to Medicare as a result of the termination of the Medicare Part A subcontract of Blue Cross Blue Shield of Connecticut ("Anthem BCBSCT").

Anthem BCBSCT does not object to the Draft Audit Report's conclusion/recommendation that Anthem BCBSCT remit to the government excess Medicare pension assets in the amount of \$1,351,284.00.

Anthem BCBSCT will incorporate this recommended amount into its discussions with CMS with respect to the final settlement of accounts related to the termination of the Connecticut Part A subcontract.

Please let me know if there are any other matters we need to discuss with respect to this audit. Anthem appreciates the professional and courteous work of your team.

Very truly yours,



T. Jeffrey Hannah

