

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**MEDICARE CONTRACTOR'S
PENSION SEGMENTATION ARKANSAS
BLUE CROSS AND BLUE SHIELD**



**JUNE GIBBS BROWN
Inspector General**

**SEPTEMBER 1998
A-07-98-02524**



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

CIN: A-07-98-02524

SEP 3 1998

Mr. Charles Clem
Vice President, Public Programs
Arkansas Blue Cross Blue Shield
601 Gaines Street
Little Rock, Arkansas 72201

Dear Mr. Clem:

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Medicare Contractor's Pension Segmentation, Arkansas Blue Cross and Blue Shield*. The purpose of our review was to evaluate Arkansas Blue Cross and Blue Shield's (Arkansas) compliance with the pension segmentation requirements of its Medicare contract. The audit addressed the update of pension assets during the period January 1, 1991 to January 1, 1996.

Our review showed that Arkansas overstated Medicare segment assets as of January 1, 1996 by \$2,017,336. The overstatement occurred primarily because Arkansas assigned Medicare segment contributions incorrectly and mis-identified participants as to Medicare and non-Medicare in calculations for Medicare benefit payments and transfers.

We recommend that Arkansas decrease the January 1, 1996 assets of the Medicare segment by \$2,017,336.

Arkansas concurred with our finding and recommendation. Their response to our draft audit report is included in its entirety as Appendix B.

INTRODUCTION

BACKGROUND

Arkansas has administered Medicare Parts A and B under a cost reimbursement contract since the start of the Medicare program. The contracts, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations (FPR), and the Cost Accounting Standards (CAS) contain reimbursement principles for cost reimbursement contracts.

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

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.

The Health Care Financing Administration (HCFA) 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.

Arkansas' contract required (1) computing the Medicare segment's actuarial liability, (2) determining the ratio of the Medicare segment's actuarial liability to the total plan actuarial liability (asset fraction), (3) allocating a portion of total pension assets as of 1986 based on the above ratio, (4) updating Medicare pension assets annually, and (5) assessing if Medicare's pension costs should be separately calculated.

The Medicare contracts identify a Medicare segment as:

...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.*

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

Our previous segmentation review (CIN: A-07-93-00668) addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1986, and the update of the segment's assets to January 1, 1991.

In reports provided for our current review, Arkansas identified total pension assets of \$35,211,927 and Medicare segment assets of \$9,111,772 as of January 1, 1996. Arkansas also concluded that separate valuations for the Medicare segment were required.

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine Arkansas' compliance with pension segmentation requirements of its Medicare contract. Achieving our objective did not require that we review the internal control structure of Arkansas. The audit addressed the update of pension assets during the period January 1, 1991 to January 1, 1996.

We performed this review in conjunction with our audits of unfunded pension costs (CIN: A-07-98-02526) and pension costs claimed for Medicare reimbursement (CIN: A-07-98-02525). The information obtained and reviewed during those audits was also used in performing this review.

We reviewed Arkansas' identification of the Medicare segment and its update of Medicare assets from January 1, 1991 to January 1, 1996.

In performing the review, we used information provided by Arkansas' consulting actuarial firm. The information included liabilities, normal costs, contributions, benefit payments, expenses, and earnings. We reviewed Arkansas' accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. We provided these documents to the HCFA pension actuarial staff who used them, along with audited asset transfer and benefit payment information, to prepare an electronic spreadsheet for updating the Medicare segment assets to January 1, 1996. We verified the direct input in the HCFA pension actuarial staff's electronic spreadsheet to source documentation. We relied on the HCFA pension actuarial staff to prepare the asset update in accordance with applicable FAR standards and CAS.

We performed site work at Arkansas' corporate offices in Little Rock, Arkansas during March and April 1998. Subsequently, we performed audit work in our Kansas City and Jefferson City, Missouri offices.

FINDING AND RECOMMENDATION

As of January 1, 1996 pension assets for the Arkansas Medicare segment were overstated by \$2,017,336. The overstatement occurred because Arkansas (1) did not equitably assign pension contributions and prepaid credits to the Medicare segment (\$1,487,314 overstatement); (2) mis-identified participants as to Medicare and non-Medicare segments when adjusting for participants that moved in and out of the Medicare segment (\$197,682 overstatement) and when calculating benefits to Medicare participants (\$359,232 understatement); and (3) inaccurately calculated Medicare earnings (\$691,572 overstatement) as a result of using inaccurate transfer, benefit and contribution amounts.

Contributions and Prepayment Credits

The Arkansas update methodology did not assign pension contributions equitably to the Medicare segment. As a result, Arkansas overstated Medicare segment assets by \$1,487,314. This occurred because Arkansas contributed more than the allowable CAS cost and did not account for the excess contributions as prepayment credits as required by CAS. Instead, Arkansas spread their entire contributions to the Medicare and non-Medicare segments. The following schedule compares audited contributions and prepayment credits, and Arkansas contributions by year.

COMPARISON OF AUDITED MEDICARE CONTRIBUTIONS AND PREPAYMENT CREDITS, AND ARKANSAS MEDICARE CONTRIBUTIONS					
YEAR	AUDITED			ARKANSAS CONTRIBUTIONS	OVERSTATEMENT
	CONTRIBUTIONS	PREPAY CREDITS	TOTALS		
1991	\$ 647,532	\$ 0	\$ 647,532	\$ 784,282	\$ 136,750
1992	589,995	140,111	730,106	913,411	183,305
1993	504,687	299,923	804,610	1,215,353	410,743
1994	165,124	774,883	940,007	1,286,061	346,054
1995	0	952,768	952,768	1,363,230	410,462
	<u>\$ 1,907,338</u>	<u>\$ 2,167,685</u>	<u>\$ 4,075,023</u>	<u>\$ 5,562,337</u>	<u>\$ 1,487,314</u>

We used the audited contributions and prepayment credits to update the Medicare segment assets (See Appendix A). Our computation resulted in a decrease of \$1,487,314 in the Medicare segment assets.

Transfers

Arkansas could not provide details to support assets transferred to and from the Medicare segment except for 1995. Consequently, we were unable to identify the reasons for differences between Arkansas and audited asset transfers for years 1991 through 1994. In 1995, the difference between the audited and Arkansas transfers resulted from mis-identification of participants as to whether they were Medicare or non-Medicare participants.

Arkansas agreed with the Medicare cost centers identified by audit which we used to do the audited transfer analyses. The following schedule compares the Arkansas and audited transfers by year.

Schedule of Transfer Adjustments For The Medicare Segment			
Years	Arkansas	Audited	Increase/(Decrease)
1991	\$ 2,228,146	\$ 1,642,456	\$ (585,690)
1992	(119,228)	(556,108)	(436,880)
1993	159,827	292,760	132,933
1994	(536,788)	(1,194,951)	(658,163)
1995	<u>(3,928,579)</u>	<u>(2,183,097)</u>	<u>1,745,482</u>
Totals	\$ <u>(2,196,622)</u>	\$ <u>(1,998,940)</u>	\$ <u>197,682</u>

We used the audited transfer amounts in updating the Medicare segment assets (Appendix A). Our computation resulted in a net increase of \$197,682 in the Medicare segment assets.

Benefit Payments

The Arkansas computations included benefit payments to Medicare participants of \$882,398 for calendar years 1991 through 1995. We identified that benefits paid to Medicare participants 1991 through 1995 was \$523,166. Arkansas was unable to provide us with detailed lists of participant benefits to support the benefits included in their asset roll-up calculations. Consequently, we were unable to identify the reason(s) for the differences between Arkansas and audited benefits. However, the differences, like in the case of the 1995 transfers, may have occurred as a result of mis-identification of inactive participants as to whether they were Medicare.

We used the audited benefit payments in our update of Medicare segment assets. The adjustment increased the Medicare assets by \$359,232 (\$882,398 less \$523,166).

Earnings

Arkansas overstated Medicare earnings because the Medicare asset base was developed using incorrect contribution, prepayment credit, transfer, and benefit amounts (discussed above). We allocated earnings using the method described in CAS 413-50(c)(7). This method allocates earnings to Medicare based on the distribution of Medicare to total company assets at the beginning of the year. Our method of allocating earnings, along with audit adjustments (for contributions, prepayment credits, transfers, and benefits) to beginning of the year assets, resulted in decreasing the Medicare segment assets by \$691,572.

We updated pension assets of the Medicare segment from January 1, 1991 to January 1, 1996 (See Appendix A). We recommend that Arkansas decrease the pension assets of the Medicare segment by \$2,017,336 as of January 1, 1996. The decrease of \$2,017,336 resulted from: (1) adjusting for participants that moved in and out of the Medicare segment (\$197,682 decrease), adjusting benefits to Medicare participants (\$359,232 increase), (3) equitably assigning pension contributions to the Medicare segment (\$1,487,314 decrease), and (4) revising earnings (\$691,572 decrease).

RECOMMENDATION

We recommend that Arkansas:

Decrease the pension assets of the Medicare segment by \$2,017,336 as of January 1, 1996.

Auditee Response

Arkansas concurred with our finding and recommendation. Their response to our draft audit report is included in its entirety as Appendix B.

INSTRUCTIONS FOR AUDITEE RESPONSE

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

Page 7 - Mr. Charles Clem

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS, reports issued to the Department's grantees and contractors are made available, if requested, 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).

Sincerely,



Barbara A. Bennett

Regional Inspector General for
Audit Services, Region VII

Enclosure

HHS Action Official:

Dr. James Farris

Regional Administrator, Region VI

Health Care Financing Administration

1301 Young Street, Room 714

Dallas, Texas 75204

ARKANSAS BLUE CROSS BLUE SHIELD
STATEMENT OF MEDICARE PENSION ASSETS
FOR THE PERIOD
JANUARY 1, 1991 THROUGH JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare	Footnotes
Assets January 1, 1991	\$17,699,203	\$14,808,106	\$2,891,097	<u>1/</u>
Contributions	2,000,000	1,352,468	647,532	<u>2/</u>
Prepayment	0	0	0	<u>3/</u>
Earnings	2,713,289	2,270,084	443,205	<u>4/</u>
Benefits	(575,857)	(561,671)	(14,186)	<u>5/</u>
Expenses	0	0	0	<u>6/</u>
Transfers	0	(1,642,456)	1,642,456	<u>7/</u>
Assets January 1, 1992	\$21,836,635	\$16,226,531	\$5,610,104	
Contributions	2,271,018	1,681,023	589,995	
Prepayment	0	(140,111)	140,111	
Earnings	1,730,769	1,275,007	455,762	
Benefits	(2,393,204)	(2,159,676)	233,528	
Expenses	0	0	0	
Transfers		556,108	(556,108)	
Assets January 1, 1993	\$23,445,218	\$17,438,882	\$6,006,336	
Contributions	3,219,582	2,714,895	504,687	
Prepayment	0	(299,923)	299,923	
Earnings	2,644,130	1,932,916	711,214	
Benefits	(985,791)	(874,519)	(111,272)	
Expenses	0	0	0	
Transfers	0	(292,760)	292,760	
Assets January 1, 1994	\$28,323,139	\$20,619,491	\$7,703,648	
Contributions	3,363,779	3,198,655	165,124	
Prepayment	0	(744,883)	744,883	
Earnings	(29,927)	(21,000)	(8,927)	
Benefits	(3,063,660)	(2,987,953)	(75,707)	
Expenses	0	0	0	
Transfers	0	1,194,951	(1,194,951)	
Assets January 1, 1995	\$28,593,331	\$21,259,261	\$7,334,070	

ARKANSAS BLUE CROSS BLUE SHIELD
STATEMENT OF MEDICARE PENSION ASSETS
FOR THE PERIOD
JANUARY 1, 1991 THROUGH JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare	Footnotes
Assets January 1, 1995	\$28,593,331	\$21,259,261	\$7,334,070	
Contributions	3,998,592	3,998,592	0	
Prepayment	0	(952,768)	952,768	
Earnings	3,723,615	2,644,447	1,079,168	
Benefits	(1,103,611)	(1,015,138)	(88,473)	
Expenses	0	0	0	
Transfers	0	2,183,097	(2,183,097)	
Assets January 1, 1996	\$35,211,927	\$28,117,491	\$7,094,436	
Assets Per Blue Cross Blue Shield	\$35,211,927	\$26,100,155	\$9,111,772	<u>8/</u>
Asset Variance	\$0	\$2,017,336	\$ (2,017,336)	<u>9/</u>

FOOTNOTES

- 1/ We calculated market value of Medicare segment assets as of January 1, 1991 during our previous segmentation review. The amounts shown for the "other" segment represent the difference between the total company and the Medicare segment.
- 2/ We obtained total contribution amounts from IRS Form 5500 reports. We allocated contributions to the Medicare segment based on the ratio of the segment's CAS funding target to the total company CAS funding target.
- 3/ Prepayment credit 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 pension trust fund until needed to fund future CAS pension costs. We allocated the prepayment in proportion to the CAS pension costs. Arkansas did not compute prepayment credits for contributions in excess of CAS cost. The audited prepayment credits are computed in accordance with CAS standards.

- 4/ We obtained earnings from actuarial valuation reports. We allocated earnings using the method described in CAS 413-50(c)(7) starting with assets developed in our prior audit.
- 5/ We identified inactive participants who were Medicare employees in the year prior to becoming inactive and asked Arkansas to provide benefit payments to these individuals for each year of the audit. The audited benefits shown here are the result.
- 6/ Arkansas did not compute administrative expenses to update Medicare assets. Consequently, we did not include administrative expenses in our update of Medicare assets.
- 7/ We identified participant transfers between segments by analyzing employee movement into and out of cost centers that were identified by us (and agreed to by Arkansas) as Medicare cost centers. To perform the transfer analyses, we used electronic data files provided to us by Arkansas.
- 8/ We obtained total asset amounts as of January 1, 1996 from the Arkansas update of assets provided by its actuary.
- 9/ The variance represents the difference between the audited calculation of assets as of January 1, 1996 and the assets calculated by the Arkansas actuary.



Arkansas
BlueCross BlueShield

601 S. Gaines St.
P.O. Box 2181
Little Rock, Arkansas 72205-2181

August 24, 1998

Ms. Barbara A. Bennett
Regional Inspector General for
Audit Services, Region VII
601 East 12th Street, Room 284A
Kansas City, MO 64106

SUBJECT: CIN A -07-98-02524

Dear Ms. Bennett:

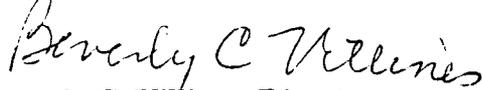
We are in receipt of the draft report of the recent reviews of our pension plan. We are in agreement with the recommendations presented and find them to properly reflect the results of actions discussed during the field work by your staff. We had previously used a rather strict definition for cost centers to include in the Medicare segment so the recommendation to decrease the value of assets assigned to the segment was expected. Further, we have forwarded to the HCFA Central Office all of the required documentation related to approval for reassignment of the unfunded pension costs, but, as you stated, this has not been finalized at this time.

These audit results have been sent on to our pension plan actuaries for their inclusion in valuation data associated with these time periods. Also, we will be working with our regional office on the cost reimbursement issues raised in the report titled "Review of Pension Costs Claimed for Medicare Reimbursement by Arkansas Blue Cross and Blue Shield".

Ms. Barbara A. Bennett
August 24, 1998
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I would like to express my thanks to your staff for the very cordial manner in which they conducted this audit. Please let me know what other actions are necessary at this time.

Sincerely,



Beverly C. Villines, Director
Corporate Accounting

cc: Charles Clem, Vice President, Public Programs
Steven Short, Vice President, Financial Services
David Greenwood, Government Programs Accounting
Sylvia Shaw, Human Resources Administration
Faye Deacon, Hewitt Associates