DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date JUL - 3 2001

From Thomas D. Roslewicz
Deputy Inspector General
for Audit Services

Subject Audit of the Pension Plan at a Terminated Medicare Contractor, Health Care Service Corporation (A-07-00-00112)

To Neil Donovan
Director, Audit Liaison Staff
Centers for Medicare and Medicaid Services

This is to alert you to the issuance of our final audit report on July 9, 2001, identifying about $2.1 million in excess pension assets at Health Care Service Corporation (HCSC) which should be remitted to Medicare because of the closing of HCSC's Medicare segment of their pension plan. A copy is attached and copies of the report have been distributed to your staff for adjudication of the finding.

We suggest that you share this report with the Centers for Medicare and Medicaid Services (CMS)[1] components involved with monitoring the Medicare contractor financial operations, particularly the Office of Financial Management, the Center for Medicare Management, and the Office of the Actuary.

The HCSC was a Medicare contractor until their contract was terminated in 1998 and, as such, was allowed to claim Medicare reimbursement for their Medicare employees' pension costs. Regulations and the Medicare contracts provide, however, that pension gains which occur when a Medicare segment of a pension plan closes should be credited to the Medicare program. Accordingly, we are recommending that HCSC remit about $2.1 million in excess pension assets to the Medicare program.

We solicited, but did not receive, a response from HCSC concerning our review. HCSC's failure to comment on our finding and recommendation does not affect the results of our review.

If you need additional information about this report, please contact James P. Aasmundstad, Regional Inspector General for Audit Services, Region VII, 816-426-3591.

Attachment

[1]Formerly known as the Health Care Financing Administration.

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

AUDIT OF THE PENSION PLAN AT A TERMINATED MEDICARE CONTRACTOR, HEALTH CARE SERVICE CORPORATION

JULY 2001
A-07-00-00112

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-07-00-00112

Mr. John K. Jansson
Vice President
Audit & Performance Review
Health Care Service Corporation
300 East Randolph Street, 11th floor
Chicago, Illinois 60601-5099

Dear Mr. Jansson:

This report provides the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review entitled, "Audit of the Pension Plan at a Terminated Medicare Contractor, Health Care Service Corporation." The purpose of our review was to determine the excess assets that should be remitted to Medicare by Health Care Service Corporation (HCSC) because of the termination of the Medicare contractual relationship in 1998.

We computed excess Medicare pension assets of $2,148,287 as of September 30, 1998, which HCSC should remit to the Federal Government. HCSC did not comment on our finding and recommendation.

INTRODUCTION

BACKGROUND

The HCSC administered Medicare Parts A and B under cost reimbursement contracts until the contractual relationship terminated in 1998. 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), the Cost Accounting Standards (CAS), and the Medicare contracts.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. 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 Centers for Medicare and Medicaid Services (CMS)[1] 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.

In our report entitled, "Review of Medicare Contractor's Pension Segmentation, Health Care Service Corporation," dated August 8, 1994 (A-07-94-00763), we addressed the update of Medicare segment assets from January 1, 1986 to January 1, 1992.

The HCSC's Medicare Part A and B contracts were terminated in July and August 1998. The majority of HCSC's Medicare segment employees were terminated by August 31, 1998, but some remained until November 1998. 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

[1]Formerly known as the Health Care Financing Administration.

> 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."

Medicare contracts specifically prohibit any profit (gain) from Medicare activities. Therefore, according to the contract, pension gains that 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)).

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards, except that we have not included HCSC's views concerning our finding and recommendation. We solicited, but did not receive, a response from HCSC concerning our review. The HCSC's failure to comment on our finding and recommendation does not affect the results of our review. Our objective was to determine the amount of excess assets that should be remitted to Medicare as a result of the contract termination and Medicare segment closing. Achieving the objective did not require a review of HCSC's internal control structure.

The HCSC's Medicare contracts were terminated in July and August 1998. However, a few Medicare employees remained until November 1998. HCSC suggested, and we agreed, that September 30, 1998 would be an appropriate settlement date for the closing of the segment. We, therefore, reviewed HCSC's identification of the Medicare segments and its update of Medicare assets from January 1, 1992 to September 30, 1998.

In performing the review, we used information provided by Towers Perrin, HCSC's consulting actuary. The information included liabilities, normal costs, contributions, benefit payments, earnings, and administrative expenses. We reviewed HCSC's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, we verified HCSC's update of Medicare segments assets to September 30, 1998. The CMS pension actuarial staff reviewed our methodology and calculations.

The HCSC has two defined benefit pension plans - the Union plan and the Regular plan. For presentation purposes, this report combines the assets of both plans. APPENDICES A and B separately detail the pension assets of the two plans.

Site work was performed at HCSC's corporate offices in Chicago, Illinois. We performed subsequent audit work in our OIG, OAS Jefferson City, Missouri field office.

FINDING AND RECOMMENDATION

When HCSC's Medicare segment closed, Medicare's share of the excess pension assets was $2,148,287, which we are recommending be remitted to CMS. To determine Medicare's share, it was necessary to (1) update the segment assets to September 30, 1998, and (2) calculate the actuarial accrued liability for accrued benefits for the segment, and the excess Medicare assets.

Updating Medicare Segment Assets

As of September 30, 1998, HCSC identified Medicare segment assets of $17,824,703. We determined the Medicare segment assets to be $17,557,016 as of September 30, 1998, a decrease of $267,687. The decrease occurred primarily because HCSC allocated contributions to the Medicare segment in excess of the amounts required to fund the CAS pension costs.

Calculation of Actuarial Accrued Liability and Excess Medicare Assets

We computed the Medicare actuarial accrued liability (closing liabilities) to be $15,408,729 (see APPENDICES A and B for details). After considering the Medicare segment assets of $17,557,016, the excess segment assets owed to the Medicare program as of September 30, 1998 were $2,148,287 ($17,557,016 - $15,408,729).

Recommendation:

We recommend that HCSC remit $2,148,287 to the Centers for Medicare and Medicaid Services.

Auditee Response:

HCSC did not comment on our finding and recommendation.

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determinations as to actions to be taken on all matters reported will be made by the Department of Health and Human Services (HHS) action official identified below. 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 the final determination.

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 the exemptions in the Act which the Department chooses to exercise. (See 45 CFR part 5.)

Sincerely,

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

Enclosures

HHS Action Official:
Ms. Dorothy Burk Collins
Regional Administrator, Region V
Centers for Medicare and Medicaid Services
233 North Michigan Avenue, Suite 600
Chicago, Illinois 60601

HEALTH CARE SERVICE CORPORATION – Plan 001

CIN: A-07-00-00112

STATEMENT OF MEDICARE PENSION ASSETS

JANUARY 1, 1992 TO SEPTEMBER 30, 1998

1/1/92 Market Value	1/	**$ 46,549,962**	**$ 40,573,963**	**$ 2,670,317**	**$ 3,305,682**	**$ -**	**$ -**	**$ -**
Contributions	2/	5,630,280	4,970,817	319,241	340,222	-	-	-
Investment Return	3/	1,336,606	1,165,015	76,674	94,917	-	-	-
Benefit payments	4/	(998,479)	(881,655)	(81,262)	(35,562)	-	-	-
12/31/92 Market Value		52,518,369	45,828,140	2,984,970	3,705,259	-	-	-
								-
1/1/93 Market Value		**52,518,369**	**45,828,140**	**2,984,970**	**3,705,259**	**-**	**-**	-
Contributions		9,028,723	7,965,009	460,840	602,874	-	-	-
Earnings on investment		6,171,960	5,385,724	350,794	435,442	-	-	-
Benefit payments		(1,709,049)	(1,634,575)	(51,509)	(22,965)	-	-	-
12/31/93 Market Value		66,010,003	57,544,298	3,745,095	4,720,610	-	-	-
								-
1/1/94 Market Value		**66,010,003**	**57,544,298**	**3,745,095**	**4,720,610**	**-**	**-**	-
Contributions		9,131,658	8,171,122	421,223	539,313	-	-	-
Earnings on investment		52,049	45,374	2,953	3,722	-	-	-
Benefit payments		(2,003,916)	(1,840,545)	(117,295)	(46,076)	-	-	-
12/31/94 Market Value		73,189,794	63,920,249	4,051,976	5,217,569	-	-	-
FEP Spin-Off		-	(1,206,052)	-	-	1,206,052	-	-
12/31/94 Market Value		73,189,794	62,714,197	4,051,976	5,217,569	1,206,052	-	-
								-
1/1/95 Market Value		**73,189,794**	**62,714,197**	**4,051,976**	**5,217,569**	**1,206,052**	**-**	-
Contributions		14,998,706	13,649,786	365,922	548,453	167,407	13,285	253,853
Earnings on investment		18,135,338	15,539,641	1,004,019	1,292,836	298,842	-	-
Benefit payments		(2,231,178)	(2,122,805)	(72,091)	(23,961)	(12,321)	-	-
12/31/95 Market Value		104,092,660	89,780,819	5,349,826	7,034,897	1,659,980	13,285	253,853
1/1/96 Market Value		**104,092,660**	**89,780,819**	**5,349,826**	**7,034,897**	**1,659,980**	**13,285**	**253,853**
Payment transfer	5/	**-**	(751,692)	294,340	305,090	-	23,958	128,304
Contributions		10,886,070	9,960,933	362,255	375,487	-	29,486	157,909
Earnings on investment		14,404,035	12,342,494	772,128	1,003,482	218,955	6,890	60,086
Benefit payments		(4,072,679)	(3,762,117)	(135,900)	(95,055)	(59,488)	-	(20,119)
12/31/96 Market Value		125,310,086	107,570,437	6,642,649	8,623,901	1,819,447	73,619	580,033
1/1/97 Market Value		**125,310,086**	**107,570,437**	**6,642,649**	**8,623,901**	**1,819,447**	**73,619**	**580,033**
Payment transfer		**-**	(698,795)	199,455	328,450		29,317	141,573
Contributions		4,953,431	4,248,102	201,320	331,520	-	29,592	142,897
Earnings on investment		23,794,382	20,361,511	1,273,813	1,641,626	345,613	21,604	150,215
Benefit payments		(5,582,190)	(4,066,156)	(506,964)	(989,497)	(12,864)	(6,709)	-
Transfers		-	451,000	-	-	(451,000)	-	-
12/31/97 Market Value		148,475,709	127,866,099	7,810,273	9,936,000	1,701,196	147,423	1,014,718

HEALTH CARE SERVICE CORPORATION – Plan 001

CIN: A-07-00-00112

STATEMENT OF MEDICARE PENSION ASSETS

JANUARY 1, 1992 TO SEPTEMBER 30, 1998

1/1/98 Market Value	**148,475,709**	**127,866,099**	**7,810,273**	**9,936,000**	**1,701,196**	**147,423**	**1,014,718**
Payment transfer	-	(361,385)	-	115,624	-	45,436	200,325
Contributions	-	-	-	-	-	-	-
Earnings on investment	2,064,571	1,773,482	109,102	139,612	23,863	2,723	15,789
Benefit payments	(4,471,297)	(3,766,783)	(164,484)	(324,903)	(21,852)	-	(193,275)
9/30/98 Market Value	146,068,983	125,511,413	7,754,891	9,866,333	1,703,207	195,582	1,037,557
Transfers 6/	-	3,543,963	(1,608,710)	(1,899,909)	-	(35,344)	-
9/30/98 Market Value	$146,068,983	$129,055,376	$6,146,181	$7,966,424	$1,703,207	$160,238	$1,037,557

Calculation of CAS 413-50(c)(12) Segment Closing Adjustment

Description	Notes	Total Medicare	Segment 2 HCSC Med A	Segment 3 HCSC Med B	Segment 6 HCSA Med A	Segments 7 & 8 HCSA Med B
As of September 30, 1998:						
PV of Lump Sums	7/	$ 11,650,867	$ 4,387,234	$ 5,942,251	$ 164,002	$ 1,157,380
ABCM Actuarial Liability	8/	2,596,876	996,013	1,470,467	40,824	89,572
Closing Liability		14,247,743	5,383,247	7,412,718	204,826	1,246,952
- Market Value of Assets		15,310,400	6,146,181	7,966,424	160,238	1,037,557
+ AV of Prepayments		-	-	-	-	-
Segment Closing Adjustment		$(1,062,657)	$ (762,934)	$(553,706)	$ 44,588	$ 209,395

HEALTH CARE SERVICE CORPORATION – Plan 001

CIN: A-07-00-00112

STATEMENT OF MEDICARE PENSION ASSETS

JANUARY 1, 1992 TO SEPTEMBER 30, 1998

FOOTNOTES TO STATEMENT OF MEDICARE PENSION ASSETS

1. The January 1, 1992 beginning balances were established by our prior audit at HCSC (A-07-94-00763).

2. We obtained total contribution amounts from IRS Form 5500 reports. We assigned contributions to the Medicare segments based on the ratio of the segments' year-end CAS required funding to the total company's year-end CAS required funding. HCSC, however, used actual contributions and allocated to segments based on the expected CAS cost for the year.

3. We obtained the total investment return from the actuarial valuation reports. We assigned net earnings (gross earnings less expenses) based on the ratio of beginning of year market value of Medicare assets to the beginning of year market value of total assets.

4. We obtained total benefit payments from the actuarial valuation reports. We based the Medicare segments' benefit payments on actual payments to Medicare retirees.

5. The 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 trust fund until needed to fund future CAS pension costs. We allocated the prepayment in proportion to the CAS pension costs. HCSC did not compute prepayment credits for contributions in excess of CAS cost. The audited prepayment credits are computed in accordance with CAS standards.

6. We adjusted for active participants that transferred from the Medicare segment to non-Medicare cost centers when the segment closed. For active transfers, we used the accrual benefit cost method-actuarial liabilities (ABCM-AL) as of 1/1/99, discounted back 3 months to 09/30/98 using the valuation annual interest rate of 8.25 percent.

7. We obtained actual lump-sum payment amounts and dates of payment from HCSC. We discounted the lump-sum amounts back to 09/30/98 using compound interest and the valuation annual interest rate of 8.25 percent.

8. We computed the ABCM-AL actuarial liabilities as follows:

   - For deferred inactives who had not received a lump sum by 9/30/98, we discounted the 01/01/99 ABCM-AL back 3 months to 09/30/98 using compound interest and the valuation annual interest rate of 8.25 percent. (Note: For inactives the ABCM-AL = project unit credit (PUC)-AL.)

HEALTH CARE SERVICE CORPORATION – Plan 001

CIN: A-07-00-00112

STATEMENT OF MEDICARE PENSION ASSETS

JANUARY 1, 1992 TO SEPTEMBER 30, 1998

- For retirees, we discounted the 01/01/99 ABCM-AL back 3 months to 09/30/98 using compound interest and the valuation annual interest rate of 8.25 percent. (Note: For inactives the ABCM-AL = PUC-AL.) We discounted benefit payments made subsequent to the settlement date back to 9/30/98.

HEALTH CARE SERVICE CORPORATION – Plan 002

CIN: A-07-00-00112

STATEMENT OF MEDICARE PENSION ASSETS

JANUARY 1, 1992 TO SEPTEMBER 30, 1998

Date	Notes	Description	Total Company	HCSA Med A	HCSA Med B
07/24/1994	**1/**	**Market Value of Assets**	**$ -**	**$ -**	**$ -**
	2/	Employer Contribution	277,281	60,582	216,699
	3/	Investment Return	-	-	-
	4/	Benefit Payments	-	-	-
12/31/1994		Market Value of Assets	277,281	60,582	216,699
01/01/1995		**Market Value of Assets**	**277,281**	**60,582**	**216,699**
	5/	Prepayment Transfer	-	(282)	282
		Employer Contribution	426,124	94,619	331,505
		Investment Return	2,760	600	2,160
		Benefit Payments	(8,854)	-	(8,854)
12/31/1995		Market Value of Assets	697,311	155,519	541,792
01/01/1996		**Market Value of Assets**	**697,311**	**155,519**	**541,792**
		Prepayment Transfer	-	-	-
		Employer Contribution	712,090	217,980	494,110
		Investment Return	46,228	11,173	35,055
		Benefit Payments	(31,285)	(1,781)	(29,504)
12/31/1996		Market Value of Assets	1,424,344	382,891	1,041,453
01/01/1997		**Market Value of Assets**	**1,424,344**	**382,891**	**1,041,453**
		Prepayment Transfer	-	(54,760)	54,760
		Employer Contribution	647,481	181,840	465,641
		Investment Return	131,717	31,213	100,504
		Benefit Payments	(22,424)	(4,856)	(17,568)
12/31/1997		Market Value of Assets	2,181,118	536,328	1,644,790
01/01/1998		**Market Value of Assets**	**2,181,118**	**536,328**	**1,644,790**
		Prepayment Transfer	-	(61,367)	61,367
		Employer Contribution	387,132	57,893	329,239
		Investment Return	(308,699)	(67,284)	(241,415)
		Benefit Payments	(12,935)	(1,948)	(10,987)
09/30/1998		**Market Value of Assets**	**$ 2,246,616**	**$ 463,622**	**$ 1,782,994**

HEALTH CARE SERVICE CORPORATION – Plan 002

CIN: A-07-00-00112

STATEMENT OF MEDICARE PENSION ASSETS

JANUARY 1, 1992 TO SEPTEMBER 30, 1998

Date	Notes	Description	Total Medicare	HCSA Med A	HCSA Med B

Calculation of CAS 413-50(c)(12) Segment Closing Adjustment

As of September 30, 1998:

6/ PV Lump Sums	$ 53,018	$ 2,386	$ 50,632
7/ ABCM Actuarial Liabiltiy	1,107,968	178,922	929,046
Closing Liability	1,160,986	181,308	979,678
Mkt Value of Assets	2,246,616	463,622	1,782,994
Segment Closing Adjst	$ (1,085,630)	$ (282,314)	$ (803,316)

HEALTH CARE SERVICE CORPORATION – Plan 002

CIN: A-07-00-00112

STATEMENT OF MEDICARE PENSION ASSETS

JANUARY 1, 1992 TO SEPTEMBER 30, 1998

FOOTNOTES TO STATEMENT OF MEDICARE PENSION ASSETS

1. This plan was adopted on July 26, 1994, so there were no assets as of that date.

2. We obtained total contribution amounts from IRS Form 5500 reports. We assigned contributions to the Medicare segments based on the ratio of the segments' year-end CAS required funding to the total company's year-end CAS required funding. HCSC, however, used actual contributions and allocated to segments based on the expected CAS cost for the year.

3. We obtained the total investment return from the actuarial valuation reports. We assigned net earnings (gross earnings less expenses) based on the ratio of beginning of year market value of Medicare assets to the beginning of year market value of total assets.

4. We obtained total benefit payments from the actuarial valuation reports. We based the Medicare segments' benefit payments on actual payments to Medicare retirees.

5. The 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 trust fund until needed to fund future CAS pension costs. We allocated the prepayment in proportion to the CAS pension costs. HCSC did not compute prepayment credits for contributions in excess of CAS cost. The audited prepayment credits are computed in accordance with CAS standards.

6. We obtained actual lump-sum payment amounts and dates of payment from HCSC. We discounted the lump-sum amounts back to 09/30/98 using compound interest, and the valuation annual interest rate of 8.25 percent.

7. We computed the ABCM-AL actuarial liabilities as follows:

   - For deferred inactives who had not received a lump sum by 9/30/98, we discounted the 01/01/99 ABCM-AL back 3 months to 09/30/98 using compound interest and the valuation annual interest rate of 8.25 percent. (Note: For inactives the ABCM-AL = PUC-AL.)

   - For retirees, we discounted the 01/01/99 ABCM-AL back 3 months to 09/30/98 using compound interest and the valuation annual interest rate of 8.25 percent. (Note: For inactives the ABCM-AL = PUC-AL.) We discounted benefit payments made subsequent to the settlement date back to 9/30/98.