DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

MAR - 8 2004

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

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

SUBJECT: Audit of the Pension Plan at a Terminated Medicare Contractor, Horizon Blue Cross Blue Shield of New Jersey (A-07-02-03028)

Attached is an advance copy of our final report on the audit of Horizon Blue Cross Blue Shield pension plan. We will issue this report to Horizon Blue Cross Blue Shield, a terminated Medicare contractor, within 5 business days. We suggest you share this report with the Centers for Medicare & Medicaid Services's components involved in monitoring the Medicare contractors' financial operations, particularly the Office of Financial Management, the Center for Medicare Management, and the Office of the Actuary.

The objectives of our audit were to assess Horizon's compliance with pension segmentation requirements pursuant to its Medicare contract and to determine the amount of excess assets that should be remitted to the Federal Government as a result of the contract termination.

Horizon was a Medicare contractor until its contract was terminated in 2000. As such, it was allowed to claim reimbursement for its Medicare employees' pension costs. Because Medicare contracts specifically prohibit contractors from profiting from Medicare activities, pension gains which exist when a Medicare segment closes must be credited back to the program. Accordingly, we recommended that Horizon remit $3,812,504 in excess pension assets to the Medicare program.

Horizon partially agreed with our report. In its response to our draft report, Horizon stated that we used an inconsistent methodology to compute the Government's share of excess assets. Horizon also stated that we used an inequitable segment closing date to value the segment assets. Horizon proposed an alternative methodology and segment closing date that resulted in excess Medicare pension assets of $3,129,645.

We disagree with Horizon's response because it is not consistent with the requirements of the Federal Acquisition Regulations and Cost Accounting Standards 412 and 413, which govern the calculation of and accounting for pension costs charged to Medicare. We found nothing in Horizon's response that would cause us to change our opinion. The CMS Office of the Actuary supports our position.

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 George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through e-mail at GREEB@oig.hhs.gov. Please refer to report number A-07-03-03028 in all correspondence.

Attachment

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

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

MAR 11 2004

Report Number: A-07-02-03028

Mr. Kenneth Brause
Vice President, Investor Relations
Horizon Blue Cross Blue Shield of New Jersey
3 Penn Plaza East, PP-16T
Newark, New Jersey 07105-2210

Dear Mr. Brause:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Audit of the Pension Plan at a Terminated Medicare Contractor, Horizon Blue Cross Blue Shield of New Jersey." 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. 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 the information is not subject to exemptions in the Act which the Department chooses to exercise (see 45 CFR part 5).

Please refer to report number A-07-02-03028 in all correspondence.

Sincerely,

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

Enclosures – as stated

Directly Reply to HHS Action Official:

Ms. Judith Berek
Regional Administrator, Region II
Centers for Medicare & Medicaid Services
26 Federal Plaza, 38th Floor
New York, New York 10278

Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

AUDIT OF THE PENSION PLAN AT A TERMINATED MEDICARE CONTRACTOR, HORIZON BLUE CROSS BLUE SHIELD OF NEW JERSEY

MARCH 2004
A-07-02-03028

EXECUTIVE SUMMARY

OBJECTIVES

The objectives of our audit were to assess Horizon Blue Cross Blue Shield of New Jersey's (Horizon) compliance with pension requirements pursuant to its Medicare contract and to determine the amount of excess assets that should be remitted to the Federal Government as a result of the contract termination.

FINDING

Horizon's Medicare Part A contract was terminated effective July 31, 2000 and its Medicare segment was closed on that date.

Federal regulations and the Medicare contracts provide that pension gains that exist when a Medicare segment of a pension plan closes are to be credited to the Medicare program.

Excess pension assets existed at the time Horizon terminated its Medicare contract. Horizon maintained two separate pension plans: the Management plan and the Union plan. We computed excess Medicare pension assets of $1,524,224 in the Management plan and $2,288,280 in the Union plan. This resulted in a total of $3,812,504, as of July 31, 2000, that should be remitted to the Federal Government, as required by the Medicare contract and the Cost Accounting Standards (CAS).

RECOMMENDATION

We recommended that Horizon remit $3,812,504 to the Federal Government for excess Medicare pension assets remaining at the termination of its Medicare contract.

AUDITEE'S COMMENTS

Horizon partially agreed with our report. In its response to our draft report, Horizon stated that we used an inconsistent methodology to compute the Government's share of excess assets. Horizon also stated that we used an inequitable segment closing date to value the segment assets. Horizon proposed an alternative methodology and segment closing date that resulted in excess Medicare pension assets of $3,129,645.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We do not agree with Horizon's suggested revisions to the aggregate percentages and the contract closing dates for its Management and Union plans. Our calculations of the aggregate Medicare percentage and the use of the July 31, 2000 closing date are in accord with the CAS.

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INTRODUCTION

BACKGROUND

Horizon administered Medicare Part A operations under a cost reimbursement contract until July 31, 2000, when the contract was terminated and Horizon's Medicare segment was closed.

Since its inception, Medicare has paid a portion of Medicare contractors' annual contributions to their pension plans. In claiming cost reimbursements, contractors are to follow the principles contained in the Federal Acquisition Regulations (FAR, which superseded the Federal Procurement Regulations (FPR)), CAS, and the Medicare contracts. These payments represent allowable pension costs under FAR and the earlier FPR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.[1]

The Centers for Medicare & Medicaid Services (CMS), incorporated segmentation requirements into Medicare contracts beginning in fiscal year 1988. The Medicare contracts define a segment and require separate identification of the pension assets for the Medicare segment,[2] including the methodology for the initial allocation of pension assets to the Medicare segment. The contract further requires that, in accordance with CAS 413, the Medicare segment assets be updated for each year after the initial allocation.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of our audit were to assess Horizon's compliance with pension segmentation requirements pursuant to its Medicare contract and to determine the amount of excess assets that should be remitted to the Federal Government as a result of the contract termination.

Scope

We reviewed Horizon's identification of the Medicare segment, its computation of the initial assets allocated to the Medicare segment, and its update of Medicare assets from January 1, 1986

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

[2] According to the Medicare contracts,

> 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 agreement/contract, 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.

to the termination of the contract on July 31, 2000. We did not review Horizon's internal control structure because it was not relevant to the objectives of our audit.

Methodology

In conducting our review, we used information provided by Horizon's prior and current consulting actuarial firms. The information included liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We examined Horizon's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, the CMS pension actuarial staff and the Office of Inspector General (OIG) auditors reviewed Horizon's update of Medicare segment assets from January 1, 1986 to July 31, 2000.

We performed audit work at Horizon's corporate office in Newark, New Jersey, during April 2002. Our audit was performed in accordance with generally accepted government auditing standards.

FINDING AND RECOMMENDATION

We found that when Horizon's Medicare segment was terminated, Medicare's share of the excess pension assets was $3,812,504, which is due to be remitted to the Federal Government.

Because Medicare contracts specifically prohibit any profit (gain) from Medicare activities, pension gains which occur when a Medicare segment closes should be credited back 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 the termination of a defined benefit pension plan, or such assets are constructively received by it for any reason, the contractor shall refund or credit the Government an amount equal to its equitable share (FAR § 31.205-6(j)(4) and CAS at 9904.413-50(c)(12)).[3]

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[3] 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.

As of July 31, 2000, Horizon calculated total excess Medicare segment pension assets of $4,257,952, composed of $1,861,861 in its Management plan and $2,396,091 in its Union plan. We reviewed Horizon's initial allocation of assets as of January 1, 1986, the update of Medicare segment assets to July 31, 2000, and the computation of total excess Medicare segment pension assets as of July 31, 2000. We found Horizon's computations to be materially accurate.

However, because Horizon's Medicare segment was not totally devoted to Medicare operations, only a portion of the excess segment assets was attributable to Medicare. To arrive at Medicare's share of the excess assets, we calculated the segments' aggregate Medicare percentages and applied them to the segments' total excess assets. We computed the segments' aggregate Medicare percentages as the ratio of the segments' pension costs claimed for Medicare reimbursement to the segments' total pension costs. The resulting aggregate Medicare percentages were 81.8656 for the Management plan and 95.5006 for the Union plan. (See Appendix A.)

By applying Medicare percentages to the excess assets, we determined that Horizon's Management plan had excess assets attributable to Medicare of $1,524,224 and that the Union plan had excess assets attributable to Medicare of $2,288,280. The sum of these amounts—$3,812,504—should be remitted to the Federal Government.

Plan	**Excess Assets as of July 31, 2000 (A)**	**Aggregate Medicare Percentage (B)**	**Excess Assets Attributable to Medicare (A x B)**
Management	$1,861,861	81.8656%	$1,524,224
Union	$2,396,091	95.5006%	$2,288,280
Total			**$3,812,504**

RECOMMENDATION

We recommend that Horizon remit $3,812,504 to the Federal Government, which we calculated to be the excess Medicare pension assets as of the termination of its Medicare contract on July 31, 2000.

AUDITEE'S COMMENTS

Horizon's comments are summarized in the following paragraphs and presented in their entirety at Appendix B.

Horizon disagreed with our use of years with no reimbursable costs in the computation of the aggregate Medicare percentage for both the Management and Union plans. Horizon stated that this practice is inconsistent and increases the Government share of the excess (surplus) pension assets.

Horizon proposed an aggregate Medicare percentage of 76.2132 (based on 3 years' data) for the Management plan and 94.5955 (based on only 1 year's data) for the Union plan. Using those percentages, Horizon computed excess pension assets of $1,418,984 for its Management plan and $2,266,594 for its Union plan.

Horizon also disagreed with the use of July 31, 2000 as the contract closing date and stated:

> Note, however, that the pension plan surplus values in the Draft Report are based on the market value of the surplus as of the contract termination date, July 31, 2000. The use of this date will "result in an inequitable calculation." CAS 9904.413-50(c)(12)(iii). The most recent market value available for the pension plan assets should be used to produce an equitable result. Horizon has previously provided CMS and the Government's auditors with a legal memorandum presenting this position. The most recent date for which the market value of the pension plan assets is available is June 30, 2003. Calculated as of this date, the Government's share of the surplus is $3,129,645.

OIG'S RESPONSE

Our comments are summarized in the following paragraphs. The CMS Office of the Actuary's comments on Horizon's response are presented in their entirety in Appendix C.

We do not agree with Horizon's suggested revisions to the aggregate Medicare percentages and the contract closing dates for its Management and Union plans. Horizon has not presented any arguments that would cause us to reconsider our findings.

Our calculations of the aggregate Medicare percentages are consistent with the requirements of CAS and therefore accurately identify the Government's share of the excess pension assets. We requested segmented salary or pension cost data for the years 1986 through 2000 from Horizon, which would have provided for more accurate calculations of the aggregate percentages. However, Horizon was only able to provide cost data for the years 1994 through 2000.

Horizon's methodology to compute the aggregate Medicare percentage for the Management plan was to use only those years during the period 1994 through 2000 when it actually claimed pension costs--that is, 1994 through 1996. It should be noted that these years represent the 3 lowest years in terms of direct Medicare percentages. Also, since Horizon did not claim any pension costs for the Union plan for any year covered by the review, it chose 1994 as the lone year on which to base the computation of the aggregate Medicare percentage. Again, the data selected by Horizon are from the year with the lowest direct Medicare percentage for the Union plan.

CAS 9904.413-50(c)(7) states that:

> 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.

Further, CAS 9904.413-50(c)(8) states that:

> If assets and liabilities are transferred, the amount of assets transferred shall be equal to the actuarial accrued liabilities, determined using the accrued benefit cost method, transferred.

The transactions of a pension plan, such as investment income and losses, benefit payments, and participant transfers between segments, occur even if a contractor does not claim pension costs. Horizon's proposal to use only the years that pension costs were claimed for the Management plan, and a single year of data for the Union plan, does not accurately reflect the transactions of the plans for the period covered by this review. By only including the percentages for the years with reimbursable costs, Horizon is not consistently applying the CAS requirements to its calculation. In our opinion, Horizon's methodology does not accurately calculate the Government's share of the excess pension assets.

Our methodology has consistently been to use segment salary or cost data for the period of the review to determine the aggregate Medicare percentage. CAS 9904.413-50(c)(12)(vi) states that:

> 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**. (Emphasis added.)

To be in compliance with CAS, we used all of the segmented data made available by Horizon (1994 through 2000) to develop our aggregate percentage. We believe our methodology more accurately reflects the update of segment assets for the years covered by this review and the portion of the assets that are attributable to Medicare as of the contract closing date. We therefore maintain that the segment assets attributable to Medicare as of July 31, 2000 were $1,524,224 from Horizon's Management plan and $2,288,280 from its Union plan.

We also disagree with Horizon's claim that the use of the July 31, 2000 closing date is not in compliance with CAS because it creates an inequitable outcome. Horizon's Medicare operations ended as of July 31, 2000. We have in the past allowed contractors the option of using plan year data immediately following the contract closing date if no data were readily available as of the closing date, and if requested by the contractors to avoid the burden of incurring the additional cost of computing the data as of the closing date. However, Horizon initially agreed to July 31, 2000 as the settlement date and was able to supply asset update and valuation data as of that date.

Also, Horizon incorrectly asserted that CAS 413-50(c)(12)(iii) requires the Government to recognize factors beyond the accounting period in which the accounting event occurred. In our opinion, this provision was designed to protect both the contractor and the Government from inequitable outcomes due to short-term market anomalies that might occur around the contract closing date. It was not designed to require the Government to consider market values 3 years after the contract closing date that would result in an inequitable outcome to itself.

CAS does not require the Government to consider what is solely in the best interest of a contractor. On the contrary, CAS requires the Government to determine an outcome that is equitable for both parties. In our opinion, the most equitable outcome occurs when a contractor ceases its Medicare operations, or if necessary and reasonable, on some date closely associated to that time such as the next plan year. For Horizon, that date is July 31, 2000.

We believe the use of July 31, 2000 is in compliance with CAS and therefore results in an equitable calculation. Therefore, our position has not changed and we recommend that Horizon remit the $3,812,504 in excess Medicare pension assets as of July 31, 2000 to the Federal Government.

APPENDICES

Statement of Medicare Aggregate Percentages: Management Plan
January 1, 1986 to July 31, 2000

Year	Total Medicare Segment Pension Costs	Pension Costs Claimed for Medicare Reimbursement	Aggregate Percentage
1994 [1,2]T	$174,870	$128,673	73.5821%
1995	204,942	160,590	78.3588
1996	183,530	140,765	76.6986
1997	191,090	161,595	84.5649
1998	197,734	170,472	86.2128
1999	194,637	176,073	90.4622
2000	155,828	128,239	82.2952
	$1,302,631	**$1,066,407**	**81.8656%**

[1] Horizon was unable to provide segregated cost data for its pension plans for the years prior to 1994.

[2] For the years 1994 through 2000, we obtained segregated pension expense from data supplied by Horizon.

Statement of Medicare Aggregate Percentages: Union Plan
January 1, 1986 to July 31, 2000

Year	Total Medicare Segment Pension Costs	Pension Costs Claimed for Medicare Reimbursement	Aggregate Percentage
1994[1,2]	$17,060	$16,138	94.5955%
1995	32,377	30,923	95.5092
1996	8,897	8,539	95.9762
1997	5,927	5,757	97.1318
1998	636	620	97.4843
1999[3]	0	0	0
2000[3]	0	0	0
	$64,897	**$61,977**	**95.5006%**

[1] Horizon was unable to provide segregated cost data for its pension plans for the years prior to 1994.

[2] For the years 1994 through 2000, we obtained segregated pension expense from data supplied by Horizon.

[3] For the years 1999 and 2000, Horizon did not allocate pension expense to the Union plan.

Horizon.

Horizon Blue Cross Blue Shield of New Jersey

Pamela T. Miller, Esq.
Vice President
Enterprise Strategy and Quality

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September 12, 2003

Via Facsimile and Federal Express

Office of the Inspector General
Office of Audit Services
Department of Health and Human Services
Region VII
601 East 12th Street
Room 284A
Kansas City, MO 64106

Re: Report Number A-07-02-03028

Dear Mr. Aasmundstad:

Horizon Blue Cross Blue Shield of New Jersey ("Horizon") submits this as its response to the above-referenced draft report entitled "Audit of the Pension Plan at a Terminated Medicare Contractor, Horizon Blue Cross Blue Shield of New Jersey" for the period January 1, 1986 through July 31, 2000 (the "Draft Report"). This response is timely in that it is submitted on September 12, 2003, the extended due date agreed to by your office and communicated to us by Christine Simpson, Esq. of the Office of the General Counsel.

You assume throughout the Draft Report that the calculation of the difference between the market value of the assets and the actuarial accrued liability ('hereafter calculation of the surplus") should be made as of July 31, 2000, the date of contract termination. As indicated in previous submittals to representatives of your office and of the Centers for Medicare and Medicaid Services (CMS) and discussed further below, Horizon disagrees with your assumption.

On page 4 of the Draft Report, you apply percentages to arrive at Medicare's share of the excess pension plan assets. You use the aggregate percentages of 81.8656 percent for the Management plan and 95.5006 percent for the Union plan. We understand that these percentages were developed based on supporting information that Horizon provided for the period 1994-2000 which supported the unaudited pension expense figure originally reported on the annual Final Administrative Cost Proposals ("FACPs").

The Management plan percentage of 81.8656 percent is developed based on an average of the 1994-2000 annual Medicare percentages as shown in Appendix A to the Draft Report. With regard to the final audited and accepted CAS covered costs, we note that there were no reimbursable CAS costs after 1996 for this plan. Therefore, it is inconsistent to use the Medicare percentages developed for years after 1996 to determine the aggregate Medicare percentage to be applied to the excess assets. The correct approach is to use only the 1994 through 1996 years to develop the applicable Medicare percentage. If these years are used, the Medicare percentage for the Management plan is 76.2132 percent. Therefore, assuming that the surplus is calculated as of July 31, 2000, the Government's share of the $1,861,861 surplus for the Management plan is $1,418,984.

The Union plan percentage of 95.5006 is also developed based on an average of the 1994-2000 annual Medicare percentages as shown in Appendix A to the Draft Report. With regard to the final audited and accepted CAS costs, we note that there were no reimbursable CAS costs during the period 1988-2000. Therefore, the surplus stems from the original asset allocation prepared at the beginning of the contract period. We note that the percentage attributable to Medicare increased year over year from 1994 through 2000. Therefore, it is more appropriate to use the earliest available percentages to apply to the final excess asset figure. Thus, the 1994 value should be used; this would result in a revised Union plan Medicare percentage of 94.5955 percent. Therefore, if the surplus is calculated as of July 31, 2000, the Government's share of the $2,396,091 surplus for the Union plan is $2,266,594.

Thus, using the pension plan surplus values set forth in the Draft Report, a combined total of $3,685,578 should be remitted to the Federal Government. Note, however, that the pension plan surplus values in the Draft Report are based on the market value of the surplus as of the contract termination date, July 31, 2000. The use of this date will "result in an inequitable calculation." CAS 9904.413-50(c)(12)(iii). The most recent market value available for the pension plan assets should be used to produce an equitable result. Horizon has previously provided CMS and the Government's auditors with a legal memorandum presenting this position. The most recent date for which the market value of the pension plan assets is available is June 30, 2003. Calculated as of this date, the Government's share of the surplus is $3,129,645. Horizon will provide the details related to this calculation in its Termination Settlement Proposal.

See Attachment 1 for a chart setting out the calculations discussed in this response.

Finally, as you are aware, we are awaiting the Government's draft audit report on the pension plan costs. Although not specifically addressed in the Draft Report on the pension plan is correct and appropriate to use consistent percentages for computation of both (a) allocable pension costs and (b) the Government's share of the surplus.

Horizon notes that it will shortly be submitting its Termination Settlement Proposal to the Centers for Medicare and Medicaid Services (CMS). Due to the Government's delay in issuing the draft audit report on Horizon's pension costs, Horizon is unable to include in that proposal a final position as to the Government's share of the surplus. We have developed the tentative position set forth above and are incorporating that position into our Termination Settlement Proposal. However, Horizon reserves the right to revise all of its positions and estimates on all pension issues upon receipt and review of the Government's draft audit report on pension costs.

If you have any questions regarding this response, please contact me at (973) 466-8530. We appreciate your consideration of the issues raised in our response.

Sincerely,

Pamela T. Miller, Esq.

PTM/

Att.

cc: Scott Englund, Department of Health and Human Services
Christine Simpson, Esq., CMS
John Campbell, Esq., Horizon-BCBSNJ
Michael Kaplan, Esq., Horizon-BCBSNJ
Robert Pures, Horizon-BCBSNJ
William Frantel, Horizon-BCBSNJ
W. Bruce Shirk, Esq., Powell, Goldstein, Frazer & Murphy LLP
Maribeth Lowe, Esq., Powell, Goldstein, Frazer & Murphy LLP
Steven J. Young, Huron Consulting Group
Arjun Aggarwal, Huron Consulting Group
Jay Mitchell, Towers Perrin

Attachment A

Horizon Blue Cross Blue Shield of New Jersey
Surplus Calculation Spreadsheet

Management Pension Plan Surplus Calculation			
	Government's Draft Audit Report Based on Asset Valuation Date of 07/31/00	Horizon's Position Based on Asset Valuation Date of 07/31/00	Horizon's Position Based on Asset Valuation Date of 06/30/03
Surplus based on market value of the surplus as of 07/31/00	$1,861,861	$1,861,861	-
Surplus based on market value of the surplus as of 06/30/03	-	-	$1,716,041
Medicare Percentage	81.8656%	76.2132%	76.2132%
Government's Share of the Surplus	$1,524,224	$1,418,984	$1,307,850

Union Pension Plan Surplus Calculation			
	Government's Draft Audit Report Based on Asset Valuation Date of 07/31/00	Horizon's Position Based on Asset Valuation Date of 07/31/00	Horizon's Position Based on Asset Valuation Date of 06/30/03
Surplus based on market value of the surplus as of 07/31/00	$2,396,091	$2,396,091	-
Surplus based on market value of the surplus as of 06/30/03	-	-	$1,925,879
Medicare Percentage	95.5006	94.5955	94.5955
Government's Share of the Surplus	$2,288,280	$2,266,594	$1,821,795

DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

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E-Mail EShipley@cms.hhs.gov

MEMORANDUM

To: Greg Tambke, Audit Manager, Region 7 OIG OAS

From: Eric H. Shipley Eric H Shipley

Date: November 3, 2003

Subject: Contractor Response to OIG Audit Report No. A-07-02-03028, *Audit of the Pension Plan at a Terminated Medicare Contractor, Horizon Blue Cross Blue Shield of New Jersey.*

In a letter dated September 12, 2003, Horizon Blue Cross Blue Shield of New Jersey (Horizon) responded to the above-referenced draft audit report. Your staff has expended much effort working with representatives of Horizon to ensure that both parties are in agreement concerning the data and facts used to produce the draft. Consequently, Horizon's response is limited to two comments regarding the application of the data and facts. Horizon asserts:

1. (a) that the audit report inappropriately uses Medicare percentages derived from the pension costs claimed by Horizon rather than the audited and allowable pension costs for the period; (b) that percentages for periods when the allowable cost was zero generally should not be used; and (c) that if the allowable cost is zero for all years, then the percentage should be based on claimed costs for only the single year closest to the last year of contributions.[1]

2. That the assets of the pension fund have depreciated over the last three years, the segment closing adjustment amount should be measured as of June 30, 2003, rather than as of the segment closing date of July 30, 2000, to produce an equitable result. In prior correspondence dated July 8, 2003 and addressed to me, Horizon cites the last sentence of subparagraph 9904.413-50(c)(12)(iv) of Cost Accounting Standard (CAS) 413 as the basis for using a date other than the date of the segment closing. Subparagraph 9904.413-50(c)(12)(iii) reads:

> 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

[1] Horizon also notes that it had not received the audit report on allowable pension costs as of September 12, 2003.

> termination, plan amendment, plant closure) that caused the closing of the segment, pension plan termination, or curtailment of benefits. 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.** *[Emphasis added]*

After reviewing Horizon's objections and reasoning, I conclude that the findings of your draft audit are materially correct as presented. The basis for my conclusion is presented below.

1. Medicare Percentages Used to Determine CMS' share of the Segment Closing Adjustment.

Background

The original 9904.413-50(c)(12) segment provision did not provide specific guidance on the determination of the government's share of the segment closing adjustment. Such guidance was added by the March 30, 1995 amendments, which state at 9904.413-50(c)(12)(vi):

> 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. *** *[Emphasis added]*

The Cost Accounting Standards Board (CASB) included the following guidance in response to comments regarding the Advanced Notice of Proposed Rulemaking (ANPRM) and Notice of Proposed Rulemaking (NPRM). The comments requesting such guidance were discussed in the preamble to the amendments.

> <u>Comment</u>: Four commenters asked the Board to clarify how the Government's share of the adjustment was to be determined. ***
>
> <u>Response</u>: The asset value used to determine the adjustment amount is the market value of the assets, including permitted unfunded accruals, plus portions of unfunded liability identified pursuant to 9904.412-50(a)(2), i.e., plan assets retained by the contractor due to allocated but unfunded costs. The asset value is reduced for the accumulated value of any prepayment credits since such assets have never been assigned to past periods nor allocated to Government contracts. Because this asset value represents the current value of assigned costs of prior periods, the sum of previously assigned pension costs is the denominator of the fraction. The portion of these assets attributable to the Government's participation in the funding of the pension plan through cost or price is measured by the sum of costs allocated to Government contracts. **The fraction is determined based on**

> **data from years that are representative of the Government's participation, which is a factual determination best made by the contracting officer.** *[Emphasis added]*

When promulgating the amendments as a Final Rule, the CASB drew upon the proposed methodology for determining the government's share of a pension fund asset reversion that was jointly developed by the Civilian Agency Acquisition Council and the Defense Acquisition Regulation Council as part of Federal Acquisition Regulation (FAR) Case 86-69, pension plan terminations.[2] On February 9, 1987, the provision addressing the determination of the government's share was published for public comment as proposed subparagraph FAR 31.205-6(j)(4)(ii) (52 FR 4084):

> The Government's share of the adjustment of prior periods' pension costs, calculated for each segment in accordance with paragraph (j)(4)(i) of this section, shall be the product of such adjustment (net of any amount prefunded) and the ratio of pension expense absorbed by all Government contracts and subcontracts (including Foreign Military Sales) to total pension costs incurred during the 10-year period preceding the date of termination or the period from the inception date of the plan being terminated, whichever is shorter. **If this ratio cannot be determined readily, a surrogate for it may be used provided the contracting officer determines that it achieves an equitable result.**
> *[Emphasis added]*

The adjustment of the asset surplus or deficit under the amended CAS is "based on the government's historic participation in the segment's pension plan, even though the recovery of the adjustment is in the current period at the time of the segment closing." Teledyne, Inc. v. U.S., 50 Fed.Cl. 155, 179 (Fed.Cl. 2001), *aff'd* Allegheny Teledyne, Inc. v. U.S., 316 F.3d 1366 (Fed.Cir. 2003), *petition for cert filed*, 72 U.S.L.W. 3121 (U.S., Jul 29, 2003) (No. 03-165).

Discussion

If the contractor has maintained pension cost allocation records so that "readily available" data exist for a sufficient number of accounting periods to support a statistically valid representative period, then the provisions of 9904.413-50(c)(12)(vi) can be applied without further consideration. But if sufficient data do not exist, if the available data contains a disproportionate number of periods with zero dollar pension costs, or if fluctuations in the relative amount of pension costs create concerns that the result might not be representative, then other data must be used as an augmentation to or surrogate for the 9904.413-50(c)(12)(vi) fraction.

In this case, Horizon has maintained auditable allocation records of claimed pension costs for only the seven-year period from 1994 to 2000 for the Management Plan and only for the five-

[2] The Defense Acquisitions Regulation (DAR) Council Cases on Pension Plan Terminations (FAR Case 86-69), Overfunded Pension Plans, and Unfunded (Pay-As-You-Go) Pension Plans were subsumed into the CASB's pension case to amend CAS 412 and 413. Robert Lynch and I, former members of the DAR Council's CAS Policy Group, were Project Directors for the CASB's pension case.

year period from 1994 to 1999 for the Union Plan. This five to seven-year period is the minimum amount of time that can be considered as producing a historical representation of the government's participation, depending upon the stability of the government's allocated percentage. If fluctuations in the government's allocated percentage indicate that the workload or contract mix varied significantly over time, then a longer period will be required to ensure that the measurement of the government's participation in the pension plan is representative and achieves equity for both parties. Unlike the earlier proposed FAR 31.205-6(j)(4)(ii) provision, 9904.413-50(c)(12)(vi) does not specify a 10-year period. Instead, the CASB explained in the preamble to the Final Rule that what constitutes the representative period is a facts and circumstances determination to be made by the Contracting Officer.[3]

As Horizon notes in its response, the allowable and allocable pension costs for the Management Plan would be zero ($0) for Plan Years 1997 to 2000 and for the Union Plan would be zero ($0) for all Plan Years from 1994 to 2000. Horizon then proposes that the fraction for the Management Plan be based on the audited and allowable pension cost for the three-year period from 1994 to 1996 and that the fraction for the Union Plan be based on the claimed pension cost for the earliest year for which data is available, or 1994.[4]

Horizon's proposal highlights two questions: (i) How should the government's share be determined if the data are available for a period that is too short to be representative? And (ii) How is the government's allocated percentage to be determined for period during which the allocable pension cost is zero ($0)?[5]

When the specified data are not readily available for a representative period, then the government's percentage must be measured using the best available data that satisfy the purpose of 9904.413-50(c)(12)(vi). In such situations, the preamble to the 1995 amendments, as well as the proposed FAR 31.205-6(j)(4)(ii) language, indicates that it is the Contracting Officer's responsibility to determine the government's participation by a fraction that uses alternative data and achieves an equitable result.

Since 9904.413-50(c)(12)(vi) bases the percentage on the allocation of pension costs, any consideration of an alternative must begin with the fundamental components that comprise pension cost–i.e., normal cost plus amortization installments towards the unfunded actuarial liability caused by plan changes, assumption and method changes, and experience gains and losses.[6] For each year during which the government participated in the cost of the pension plans,

[3] One of the functions of an OIG report is to make recommendations to the CMS Contracting Officer.
[4] I presume that the audit report will discuss the inconsistency of using the audited and allowable cost for the Management Plan and the claimed cost for the Union Plan, and of using the one-year of data for the Union Plan that is most favorable to the contractor when other years of data are available.
[5] For any period during which the total allocable pension cost is zero, dividing the $0 pension cost allocated to the government by the total allocable pension cost of $0 has an indeterminate result.
[6] The CASB has always set forth the components of "pension cost" for qualified defined-benefit pension plans at 9904.412-40(a)(1) as: "(i) the normal cost of the period, (ii) a part of any unfunded actuarial liability, (iii) an interest equivalent on the unamortized portion of any unfunded actuarial liability, and (iv) an adjustment for any actuarial gains and losses."

the plans did incur a normal cost, and the unfunded actuarial liability (or surplus) increased or decreased due to plan changes, assumption changes, and experience gains and losses all of which would eventually be recognized as period costs or be subsumed within the segment closing adjustment. It is therefore illogical to treat the government as not having a participatory interest in the pension plan during a period of time when the results of the specified segment closing fraction is indeterminate. At no time during 1994 to 2000 was the government's percentage of participation in the accumulation of the liability equal to zero.

Similarly, examining the source of the segment's assets as accumulated in accordance with 9904.413-50(c)(7)[7] and (8)[8] shows that each year the assets increased or deceased due to investment experience, administrative expenses, benefit payments, and any transfer adjustments regardless of whether or not a contribution was made for the period. At no time during 1994 to 2000 was the government's percentage of participation in the accumulation of the assets equal to zero.

The purpose of 9904.413-50(c)(12)(vi) was to measure the government's allocable percentage of pension costs based on its years of participation in the pension plan. Thus any surrogate measure must use the same allocation basis that was used for pensions. The surrogate must also use a period of time sufficiently long to reflect any high and low periods of participation in an unbiased manner. Using a statistic based on only one year of data to ascertain the government's historical level of participation is contrary to the purpose of 9904.413-50(c)(12)(vi). And, because of the paucity of data, it is impossible to judge whether 1994 was a representative year for the Union plan.

Normally, the OIG auditors measure the government's percentage of the segment closing adjustment using the ratio of salary dollars allocated to the Medicare contract because most contractors use the same base to allocate pension costs and salary dollars and because this approach treats all terminating Medicare contractors consistently. They have found that data regarding allocated salary dollars are usually available for the entire period covered by the

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[7] Both the original and current CASB discussed the accumulation of segments assets at 9904.413-50(c)(7), which currently reads:

> "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. Income and expenses shall include a portion of any investment gains and losses attributable to the assets of the pension plan. Income and expenses of the pension plan assets shall be allocated to the segment in the same proportion that the average value of assets allocated to the segment bears to the average value of total pension plan assets for the period for which income and expenses are being allocated."

[8] 9904.413-50(c)(8), as amended, reads:

> "If plan participants transfer among segments, contractors need not transfer assets or actuarial accrued liabilities unless a transfer is sufficiently large to distort the segment's ratio of pension plan assets to actuarial accrued liabilities determined using the accrued benefit cost method. If assets and liabilities are transferred, the amount of assets transferred shall be equal to the actuarial accrued liabilities, determined using the accrued benefit cost method, transferred."

Medicare contract's pension clause, Item XVI of Appendix B.[9] Furthermore, because salary levels are fairly stable over the period of measurement, any inequity due to volatility in the amount of pension costs is avoided and the measurement does not favor either party. In this case, such auditable salary data were not maintained by Horizon and, were, therefore, not available. However, Horizon did retain records of claimed pension costs for 1994 to 2000, and the same allocation base, productive hours, that was used to claim costs, was used to allocate the audited and allowable costs.

Because there are no data for the periods prior to 1991, it is impossible to know whether the percentage developed in the audit report is under- or overvalued. To ensure that the audit report results using available claimed cost data are indeed representative, I developed percentages shown below using all available productive-hour data for 1991 to 2000. (See Appendix A and B for details.) I find that these results are similar to the percentages used in the audit report. (These results should not replace the report findings, as they include some projected and interpolated values rather than audited data.) I also find that the audit report's results are consistent with Horizon's general belief that the Medicare Unit always allocated close to 100 percent to Medicare and the Provider Audit and Reimbursement Unit allocated about 60 to 70 percent to Medicare.

Management Plan

	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991	Historical Average
Productive Hours	82.29%	90.46%	88.18%	86.59%	77.80%	80.25%	74.90%	100.00%	78.46%	72.34%	81.1426%
Draft Audit Report	82.30%	90.46%	86.21%	84.56%	76.70%	78.36%	73.58%	n/a	n/a	n/a	81.8656%
Horizon Response	*	*	*	*	76.70%	78.36%	73.58%	n/a	n/a	n/a	76.2132%

* Zero pension cost – indeterminate percentage

Union Plan

	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991	Historical Average
Productive Hours	95.31%	97.46%	97.39%	97.01%	95.85%	95.46%	94.46%	100.00%	93.37%	89.63%	94.8491%
Draft Audit Report	*	*	97.48%	97.13%	95.98%	95.51%	94.60%	n/a	n/a	n/a	95.5006%
Horizon Response	*	*	*	*	*	*	94.60%	n/a	n/a	n/a	94.5955%

* Zero pension cost – indeterminate percentage

[9] Prior to the inclusion of CAS 413 in the Medicare contract and the FPR in 1981, the standard Medicare contract, which has always been a cost-type contract, provided for the recovery of any gains from abnormal forfeitures or other contingencies through Section 1118.7 of Appendix B and the FPR 1-15-201-5 credits provision. As part of the negotiation of the FY 1988 Medicare contracts, the contractors and CMS agreed to capture and subsume all prior accounting for pension costs, in accordance with the specific methodology regarding segment assets and liabilities described in Item XVI of the FY 1988 Appendix B.

Conclusion

Therefore, I conclude that the percentages developed in the audit report are the best measure of Medicare's participation in the pension plans.

2. Measurement Date Used to Determine Segment Closing Adjustment.

Background

"The purpose of the CAS 413 segment closing adjustment is to identify where the government may have over or under contributed to pension cost under prior contracts." Allegheny Teledyne Inc. v. U.S., 316 F.3d 1366, 1381 (Fed.Cir. 2003) *citing* Teledyne, Inc. v. U.S., 50 Fed.Cl. 155, 180 (Fed.Cl. 2001). The purpose of the segment closing adjustment is ensure that the government contributed its fair share to the pension plan, not to compensate for future fluctuations in the market.

Neither the original nor the current CASB discussed the inclusion of the phrase "or if its use can result in an inequitable calculation" in the segment closing provisions of 9904.413-12(c)(12). Nevertheless, its purpose is clear when the history of the development of the provision and the general principals pertaining to segment closing provisions are understood.

The first articulation of the segment closing provision can be found at paragraph "4__-50(c)(3)" of an exposure draft of the proposed Standard that the CASB circulated on June 18, 1976 to select interested parties for comment. At this point the proposed segment closing provision merely stated, "the date of the closing of the segment."

The phrase "[i]f such a date cannot be readily determined, the contracting parties shall agree on an appropriate date" is first found at 413-50(c)(11) in the proposed CAS 413, published as a proposed rule at 42 FR 6594 on February 3, 1977[10]:

> The requirements of paragraph (3) of this section are appropriate only for segments whose productive operations are continuing. However, if a segment is closed and a significant number of employees are thereby terminated from the plan, the contractor shall compute a net gain or loss from the plan applicable to that segment. In computing such net gain or loss, the contractor shall determine the amount of any termination gain pursuant to paragraph (c)(4) of this section. The computation shall also establish unrealized gains and losses on pension fund assets, as follows: (i) a portion of the assets of the pension fund shall be allocated to the segment in accordance with the requirements

[10] The referenced paragraph 413-50(c)(4), which primarily relates to ongoing segments, read: "Calculations of termination gains and losses shall give consideration to factors such as unexpected early retirements, benefits becoming vested, and reinstatements or transfers without loss of benefits. An amount may be estimated for reemployments."

> of paragraph (5)(i) through (iii) of this section; (ii) all of the assets shall be valued at market value as of the date of the event (e.g., contract termination) that caused the closing of the segment. **If such a date cannot be readily determined, the contracting parties shall agree on an appropriate date.** The net gain or loss from the plan for the segment shall be used as a basis for determining any appropriate adjustments consistent with existing Government contract regulations. *[Emphasis added]*

As the rule was developing, the Board was aware of the existing "abnormal forfeiture" provisions of paragraph 1-15.205-6 of the Federal Procurement Regulation (FPR). The concept of abnormal forfeiture is reflected in the proposed paragraph 413-50(c)(11) by the provision that read: "[h]owever, if a segment is closed and a significant number of employees are thereby terminated from the plan, the contractor shall compute a net gain or loss from the plan applicable to that segment." By the time CAS 413 was published as a Final Rule, the Board recognized that the events surrounding the end of a contract and closing of segment, such as a massive layoff, were unique and distinct from the normal termination of employment (turnover) experienced by an ongoing contractor and segment.

When CAS 413 was published as a Final Rule on July 20, 1977 (42 FR 37191), segment closings were separately addressed at 413-50(c)(12), and the phrase "inequitable calculation" continued to be mentioned as a factor for the parties to consider when agreeing upon the measurement date. However, the preambles to the proposed and final versions of CAS 413 do not discuss why this language was added, although the effects of a plan termination or mass termination of employees associated with the segment closing are discussed.

Paragraph 413-50(c)(12) as originally published read:

> If a segment is closed the contractor shall determine the difference between the actuarial 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 determination of the actuarial liability shall give consideration to any requirements imposed by agencies of the United States Government. In computing the market value of assets for the segment, if the contractor has not already allocated assets to the segment, such an allocation shall be made in accordance with the requirements of subdivisions (c)(5)(i) and (ii) of this subsection. The market value of the assets allocated to the segment shall be the segment's proportionate share of the total market value of the assets of the pension fund. The calculation of the difference between the market value of the assets and the actuarial liability shall be made as of the date of the event (e.g., contract termination) that caused the closing of the segment. **If such a date cannot be readily determined, or if its use can result in an inequitable calculation, the contracting parties shall agree on an appropriate date.** The difference between the market value of the assets and the actuarial liability for the segment represents an adjustment of previously-determined pension costs. *[Emphasis added.]*

Illustration 9904.413-60(c)(8) was amended in 1995 for other changes in CAS 413, but the part of the illustration referencing an inequitable calculation remained unchanged from the original promulgation. This illustration, like the text of 9904.413-50(c)(12), is focused on the date of the event that caused the segment closing. Illustration 9904.413-60(c)(8), as amended, reads:

> Contractor K has a five-year contract to operate a Government-owned facility. The employees of that facility are covered by the contractor's overall defined-benefit pension plan which covers salaried and hourly employees at other locations. At the conclusion of the five-year period, the Government decides not to renew the contract. Although some employees are hired by the successor contractor, as far as Contractor K is concerned, the facility is closed. Pursuant to 9904.413-50(c)(12), Contractor K must compute an unfunded actuarial liability for the pension plan for that facility. The contractor first calculates the actuarial liability as of the date the contract expired. Because many of Contractor K's employees are terminated from the pension plan, the Internal Revenue Service considers it to be a partial plan termination, and thus requires that the terminated employees become fully vested in their accrued benefits to the extent such benefits are funded. Taking this factor into consideration, the actuary calculates the actuarial liability as amounting to $12.5 million. The contractor must then determine the market value of the fund assets allocable to the facility, pursuant to 9904.413-50(c)(5), **as of the date agreed to by the contracting parties (9904.413-50(c)(12)), the date the contract expired.** In making this determination, the contractor establishes the ratio of the actuarial value of the assets allocable to the segment to the total actuarial value of the assets of the pension fund. The product of this ratio and the market value of all pension fund assets is the market value of the assets allocated to the segment. In this case, the market value of the segment's assets amounted to $13.8 million. Thus, for this facility the value of pension fund assets exceeded the actuarial liability by $1.3 million. This amount indicates the extent to which the Government over-contributed to the pension plan for the segment and, accordingly, indicates the extent to which prior years' pension costs are subject to adjustment. *[Emphasis added.]*

No concerns were raised about the meaning of the "inequitable date" phrase during the four-step promulgation process that culminated in the amendments to CAS 413, which were published on March 30, 1995 (60 FR 16537). Therefore, the current CASB did not address its meaning.

Discussion

As shown by the wording of the original and amended 9904.413-50(c)(12) and Illustration 413-60(c)(8), the measurement is tied to "the date of the event (e.g., contract termination)" that requires the measurement of the special adjustment. In *Teledyne*, the court found that 9904.413-50(c)(12) requires the adjustment is to be made in the accounting period in which the segment closed.

This reading is consistent with the requirements of generally accepted accounting principles as articulated by Statement 88 of the Financial Accounting Standards Board (SFAS 88) and Opinion 30 of the Accounting Principles Board (APB 30). Generally, losses are to be reported as soon as the board of directors' decision, management action, or event causing the accounting loss is adopted or occurs. Gains are to be reported when the gain is actually realized (date the segment is disposed of, benefits are curtailed, or liability is settled). In no case is the recognition or measurement delayed beyond the accounting period in which the event occurs.

The language of 9904.413-50(c)(12) permits the parties to consider other events closely associated with the contract termination that could directly affect the adjustment amount and thus the equity of the computation. For example, the layoff of employees might be delayed beyond the expiration date of the contract by activities needed to transition the workload, or a partial pension plan termination may be triggered by other employee terminations. Often the contract termination date does not coincide with the date that asset and actuarial liability valuation information is normally measured -- that is, the date on which the necessary data are readily available.

The asset measurement factor that could affect the computation of the adjustment amount would be an anomaly in the market values on the date the segment closing would otherwise be measured. By anomaly, I mean either a large increase (spike) or large decrease (drop) in the asset value that is inconsistent with normal progress and fluctuation of market values during that accounting period.[11]

The "inequitable calculation" provision permits the parties to either clarify or modify the event date to accommodate other circumstances or conditions that the parties (the contractor and the government) mutually agree should be considered. But in any case, the agreed upon measurement date must be closely associated with the event, or events, causing the segment closing.

The following are three examples of factors that have been considered by your staff when reporting on other segment closing audits at Medicare contractors. The fourth example illustrates how the asset value might be considered if an anomalous high value occurred on the segment closing date.

1. The single contract performed by the segment ended on August 31, 1998, but the parties agreed to measure the segment closing as of the immediately following scheduled actuarial valuation date, January 1, 1999. This date was chosen because the measurement

[11] Two infamous examples of such a drop occurred immediately after September 11, 2001 and on October 19, 1987. (On October 19, 1987, better known as "Black Monday," the Dow Jones industrial average collapsed by 508.32 points to close at 1,738.40, eclipsing all previous records. The Dow had dropped by 22.6 percent, which was almost twice as much a percentage drop as on October 29, 1929. The decline in 1929 was 12.82 percent. -- "Black Monday: The Stock Market Crash of 1987" by Mark Doser) In both cases, the market values increased from their precipitous lows and were re-established at new levels. It would have been inequitable to the government to use the lowest value when market values formed a new formal level shortly thereafter.

of the liability and the assets would produce similar results and because the parties could avoid the additional expenses of determining the asset and liability values on a date differing from the normal valuation date.

2. The segment performed three separate contracts. The largest contract ended on September 1, 2000, the smallest contract ended on October 1, 2000, and the other contract ended on July 1, 2000. Based on negotiations between the government and the contractor, the parties agreed to measure the segment closing adjustment on September 1, 2000, the date on which work substantively ceased. The measurement did consider liability accrued for employee service until all contract work ended on October 1, 2000.

3. The contract ended on May 30, 2001, at which time employment was terminated for all but three segment employees. The remaining three segment employees were retained until the facility could be completely shut down on February 18, 2003. The parties agreed to measure the segment closing adjustment on May 30, 2001, the date on which activities related to the contract's statement of work ended. The measurement did consider the liability accrued by the three employees who were retained until the facility was shut down.

4. The contract ended on Friday, June 27, 2003. On June 26, 2003 the market value of assets was $23,000,000, and on June 30 the market value of assets was $22,950,000. However, because of over-exuberant optimism due to world events, the market value of assets had jumped to $26,450,000 on June 27. The parties agreed that use of June 27, 2003 would be inequitable and agreed to measure the segment closing adjustment as of the next following business day, June 30, 2003. June 30 was also a date that a pension trust statement was normally scheduled to be produced, and its selection avoided any possible extra expense that would have been incurred if June 26 or June 27 had been selected.

Lastly, using the experience of the assets after the date of the segment closing and after the data are made available and audited could open the measurement up to possible manipulation by one of the parties. In the past, the audits of terminated contractors have consistently measured the adjustment in the period of the segment closing without regard to the unprecedented growth of assets during the 1990's. Your measurement of the adjustment is consistent with the intent of CAS 413 and with generally accepted accounting principles, and it has been consistently applied to all terminating contractors.

Conclusion

Although Horizon seeks to use June 30, 2003 as the measurement date for the segment closing adjustment, Horizon agreed that the segment closed on July 31, 2000, the date that the contract terminated. Horizon furthermore agreed to and did provide asset and actuarial liability valuation data as of the segment closing date. Horizon has not presented any information demonstrating that the market value of the assets on July 31, 2000 was unusually over- or undervalued as compared with other dates in July or August 2000 (when events related to the contract termination may have occurred). Therefore, I disagree with their assertion that measuring the segment closing adjustment on July 31, 2000 results in an "inequitable calculation" for either party.

Please feel free to contact me if you have any questions.

Attachments (2)

Medicare Percentage based on Productive Hours Allocated to Medicare and Employee Count -- MANAGEMENT PLAN

Fiscal Year	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991	Cumulative Results
Medicare Unit 1/											
Productive Hours 2/											
a) Medicare	70,880	90,054	52,921	76,055	84,760	61,442	87,803	69,920	102,427	116,778	813,040
b) Total	70,880	90,054	52,921	76,055	84,760	61,442	87,803	69,920	104,709	123,187	821,731
c) Medicare %	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	97.8206%	94.7973%	98.9424%
d) Employees 3/	26	30	30	24	27	26	25	n/a	n/a	n/a	
e) % of Total	43.3333%	44.7761%	43.4783%	39.3443%	42.1875%	41.2698%	40.3226%	42.1017% 4/	42.1017% 4/	42.1017% 4/	42.1017%
Provider Audit & Reimbursement Unit 5/											
Productive Hours 2/											
f) Medicare	27,721	57,280	34,676	18,184	31,019	31,929	31,385	27,833	54,567	60,494	375,088
g) Total	40,318	69,238	43,842	23,347	50,358	48,104	54,174	27,833	84,754	108,021	549,989
h) Medicare %	68.7559%	82.7291%	79.0931%	77.8858%	61.5970%	66.3749%	57.9337%	100.0000%	64.3828%	56.0021%	68.1992%
i) Employees 3/	34	37	39	37	37	37	37	n/a	n/a	n/a	
j) % of Total	56.6667%	55.2239%	56.5217%	60.6557%	57.8125%	58.7302%	59.6774%	57.8983% 4/	57.8983% 4/	57.8983% 4/	57.8983%
Management Plan Allocation Base 6/											
k) Employees 3/	60	67	69	61	64	63	62	n/a	n/a	n/a	
l) Allocation %	82.2950%	90.4624%	88.1831%	86.5865%	77.7982%	80.2519%	74.8959%	100.0000%	78.4607%	72.3355%	**81.1426%**
Claimed Pension Costs Allocation 7/											
m) Medicare	128,239	176,073	170,472	161,595	140,765	160,590	128,673	n/a	n/a	n/a	1,066,407
n) Total	155,828	194,637	197,734	191,090	183,530	204,942	174,870	n/a	n/a	n/a	1,302,631
o) Medicare %	82.2952%	90.4622%	86.2128%	84.5649%	76.6986%	78.3588%	73.5821%	n/a	n/a	n/a	**81.8656%**

1/ Identification by unit based on organization charts provided by Horizon. The Medicare Unit Includes cost centers 271, 272, 273, 274, 275, 276, 280, and 330, as well as cost center 343, Medicare information Systems.

2/ Productive hour data obtained from FACP workpapers of Robert Rist, Horizon Cost Accounting.

3/ Number of Management employees for the Medicare Unit and the Provider Audit & Reimbursement Unit for 1994 through 2000 were obtained from FACP workpapers of Robert Rist, Horizon Cost Accounting. Number of Management employees by unit for 1991 to 1993 was not available.

4/ Percentage of Management employees working in the Medicare Unit and in Provider Audit & Reimbursement Unit for 1991 to 1993 is assumed to be the same as the average percentage for 1994 to 2000.

5/ Identification by unit based on organization charts provided by Horizon. The Provider Audit & Reimbursement Unit in comprised of cost centers 666, 667, 675, and 676.

6/ Allocation is calculated by multiplying the Medicare percentage for each unit by the percentage of employees working in that unit. This approximates the allocation procedure employed by Horizon as shown in the FACP workpapers obtained from Robert Rist, Horizon cost accounting.

7/ Pension cost allocation data provided by Robert Rist, Horizon Cost Accounting, as reported in OIG Draft Audit Report A-07-02-03028, Appendix A.

Medicare Percentage based on Productive Hours Allocated to Medicare and Employee Count -- UNION PLAN

Fiscal Year	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991	Cumulative Results
Medicare Unit 1/											
Productive Hours 2/											
a) Medicare	70,880	90,054	52,921	76,055	84,760	61,442	87,803	69,920	102,427	116,778	813,040
b) Total	70,880	90,054	52,921	76,055	84,760	61,442	87,803	69,920	104,709	123,187	821,731
c) Medicare %	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	97.8206%	94.7973%	98.9424%
d) Employees 3/	34	29	35	32	33	32	33	n/a	n/a	n/a	
e) % of Total	85.0000%	85.2941%	87.5000%	86.4865%	89.1892%	86.4865%	86.8421%	86.6855% 4/	86.6855% 4/	86.6855% 4/	86.6855%
Provider Audit & Reimbursement Unit 5/											
Productive Hours 2/											
f) Medicare	27,721	57,280	34,676	18,184	31,019	31,929	31,385	27,833	54,567	60,494	375,088
g) Total	40,318	69,238	43,842	23,347	50,358	48,104	54,174	27,833	84,754	108,021	549,989
h) Medicare %	68.7559%	82.7291%	79.0931%	77.8858%	61.5970%	66.3749%	57.9337%	100.0000%	64.3828%	56.0021%	68.1992%
i) Employees 3/	6	5	5	5	4	5	5	n/a	n/a	n/a	
j) % of Total	15.0000%	14.7059%	12.5000%	13.5135%	10.8108%	13.5135%	13.1579%	13.3145% 4/	13.3145% 4/	13.3145% 4/	13.3145%
Union Plan Allocation Base 6/											
k) Employees 3/	40	34	40	37	37	37	38	n/a	n/a	n/a	
l) Allocation %	95.3134%	97.4602%	97.3866%	97.0116%	95.8483%	95.4561%	94.4650%	100.0000%	93.3685%	89.6319%	**94.8491%**
Claimed Pension Costs Allocation 7/											
m) Medicare	-	-	620	5,757	8,539	30,923	16,138	n/a	n/a	n/a	61,977
n) Total	-	-	636	5,927	8,897	32,377	17,060	n/a	n/a	n/a	64,897
o) Medicare %	- 8/	- 8/	97.4843%	97.1318%	95.9762%	95.5092%	94.5955%	n/a	n/a	n/a	**95.5006%**

1/ Identification by unit based on organization charts provided by Horizon. The Medicare Unit includes cost centers 271, 272, 273, 274, 275, 276, 280, and 330, as well as cost center 343, Medicare Information Systems.

2/ Productive hour data obtained from FACP workpapers of Robert Rist, Horizon Cost Accounting.

3/ Number of Union employees for the Medicare Unit and the Provider Audit & Reimbursement Unit for 1994 through 2000 were obtained from FACP workpapers of Robert Rist, Horizon Cost Accounting. Number of Management employees by unit for 1991 to 1993 was not available.

4/ Percentage of Union employees working in the Medicare Unit and in Provider Audit & Reimbursement Unit for 1991 to 1993 is assumed to be the same as the average percentage for 1994 to 2000.

5/ Identification by unit based on organization charts provided by Horizon. The Provider Audit & Reimbursement Unit in comprised of cost centers 666, 667, 675, and 676.

6/ Allocation is calculated by multiplying the Medicare percentage for each unit by the percentage of employees working in that unit. This approximates the allocation procedure employed by Horizon as shown in the FACP workpapers obtained from Robert Rist, Horizon cost accounting.

7/ Pension cost allocation data provided by Robert Rist, Horizon Cost Accounting, as reported in OIG Draft Audit Report A-07-02-03028, Appendix A.

8/ Dividing zero (0) by zero (0) produces an indeterminate result.