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

APR 11 2006

Report Number: A-07-06-00205

Mr. Jeff Hannah, Executive Director of Internal Controls
AdminaStar Federal, Inc.
8115 Knue Road
Indianapolis, Indiana 46250

Dear Mr. Hannah:

Enclosed are two copies of the Department of Health and Human Services, Office of Inspector General (OIG) final report entitled "Audit of Anthem Insurance Company's Unfunded Pension Costs for 1991 Through 2002." A copy of this report will be forwarded to the HHS action official noted on the next page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. 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.

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If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, ext. 274, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, ext. 21, or through e-mail at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-06-00205 in all correspondence.

Sincerely yours,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:
Ms. Jackie Garner
Regional Administrator
Centers for Medicare & Medicaid Services
233 North Michigan Avenue, Suite 600
Chicago, Illinois 60601

Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

AUDIT OF ANTHEM INSURANCE COMPANY'S UNFUNDED PENSION COSTS FOR 1991 THROUGH 2002

Daniel R. Levinson
Inspector General

APRIL 2006
A-07-06-00205

Office of Inspector General

http://oig.hhs.gov

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OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

Anthem Insurance Companies, Inc. (Anthem) administers Medicare Part A, Part B, Durable Medical Equipment, and Regional Home Health Intermediary operations under its subsidiaries, AdminaStar Federal, Inc., and Anthem Health Plans of Maine, Inc. Anthem and both subsidiaries operate under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).

On August 1, 1997, Blue Cross Blue Shield of Connecticut (Connecticut) merged with Anthem. Effective January 1, 1999, Connecticut's pension plan was merged into Anthem's pension plan. During Connecticut's prior pension segmentation/segment closing review (A-07-02-03021), it was determined that Connecticut had $4,288,024 of unfunded pension costs.

Starting with fiscal year 1988, CMS incorporated segmentation requirements into Medicare contracts. The contract specifies segmentation requirements, and requires the separate identification of unfunded costs for the Medicare segment and the business units comprising the rest of the company, which are aggregated and identified as the "Other" segment.

OBJECTIVES

Our objectives were to:

- determine if the accumulated unfunded pension costs identified in our prior reviews were accounted for properly;

- determine if pension costs for the audit period (1991–2002) were funded in accordance with the Federal Acquisition Regulations (FAR) and the Cost Accounting Standards (CAS); and

- identify and properly account for any additional accumulated unfunded pension costs, including the identification of the unallowable and reassignable portions of the accumulated unfunded pension costs.

SUMMARY OF FINDING

Anthem properly accounted for previously identified unfunded pension costs in accordance with Federal regulations. For the current audit period, Anthem funded its pension costs in accordance with the FAR and CAS. However, as a result of the merger with Blue Cross Blue Shield of Connecticut, Anthem has unallowable unfunded pension costs for the Other segment. The accumulated unallowable pension cost is $6,052,895 as of January 1, 2003.

RECOMMENDATIONS

We recommend that Anthem:

- identify $6,052,895 of accumulated unallowable pension costs as of January 1, 2003, and

- identify and properly track unallowable unfunded pension costs in subsequent years.

AUDITEE'S COMMENTS

Anthem agreed with our finding and recommendations and stated that it had already implemented policies and procedures to ensure that unallowable unfunded pension costs were properly tracked in the future. Anthem also provided information to clarify the report background. Anthem's comments are included in their entirety as an appendix.

TABLE OF CONTENTS

Glossary of Abbreviations and Acronyms

Anthem	Anthem Insurance Companies, Inc.
CAS	Cost Accounting Standards
CFR	Code of Federal Regulations
CMS	Centers for Medicare & Medicaid Services
ERISA	Employees Retirement Income Security Act of 1974
FAR	Federal Acquisition Regulations
FPR	Federal Procurement Regulations
TRA	Tax Reform Act of 1986

INTRODUCTION

BACKGROUND

Anthem and Medicare

Anthem Insurance Companies, Inc. (Anthem) administers Medicare Part A, Part B, Durable Medical Equipment, and Regional Home Health Intermediary operations under its subsidiaries, AdminaStar Federal, Inc., and Anthem Health Plans of Maine, Inc. Anthem and both subsidiaries operate under cost reimbursement contracts with the Centers for Medicare & Medicaid Services.

On August 1, 1997, Blue Cross Blue Shield of Connecticut (Connecticut) merged with Anthem. Effective January 1, 1999, Connecticut's pension plan was merged into Anthem's pension plan. During Connecticut's prior pension segmentation/segment closing review (A-07-02-03021), it was determined that Connecticut had $4,288,024 of unfunded pension costs.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. The payments are allowable pension costs under Federal Acquisition Regulations (FAR) and its predecessor, Federal Procurement Regulations (FPR). In 1980, the Medicare contracts and the FPR incorporated Cost Accounting Standards (CAS) 412 and 413.

Cost Accounting Standards

The CAS deals with stability between contract periods and requires pension costs to be consistently measured, assigned to contract periods, and allocated to cost objectives, including Federal contracts. On March 30, 1995, the Office of Federal Procurement Policy, Cost Accounting Standards Board, revised the CAS relating to accounting for pension costs. Unless otherwise noted, the following CAS citations refer to the standards that were in effect before the revision. We refer to the postrevision standards as the revised CAS. Applicable portions of the revised CAS are discussed in a later section.

The CAS, as found at 48 CFR § 9904.412-50(a)(2), stated:

> Pension costs applicable to prior years that were specifically unallowable in accordance with then existing Government contractual provisions . . . shall be separately identified and eliminated from any unfunded actuarial liability being amortized . . . . The contractor may elect to fund, and thereby reduce, such portions of unfunded actuarial liability and future interest adjustments thereon. Such funding shall not be recognized for purposes of 9904.412-50(d).

The CAS, as found at 48 CFR § 9904.412-40(c), imposes the following fundamental requirement for assigning pension costs: "Except costs assigned to future periods by 9904.412-59(c)(2) and (5), the amount of pension cost computed for a cost accounting period is assignable only to that period."

Federal Acquisition Regulations

The FAR addresses the allowability of pension costs and requires pension costs assigned to contract periods to be substantiated by funding. The FAR, as found at 48 CFR § 31.205-6(j)(1)(i), states that: ". . . the contractor shall fund pension costs by the time set for filing of the Federal income tax return or any extension. Pension costs assigned to the current year, but not funded by the tax return time, are not allowable in any subsequent year."

Conflict Between FAR Funding Requirement and Tax Limits

Pension costs computed in accordance with the CAS typically differ from the contribution amount otherwise determined in accordance with the Employees Retirement Income Security Act (ERISA) of 1974, which added minimum funding requirements and amended the tax-deductible limits in the Internal Revenue Code.

Under tax laws in effect before 1986, employers could fund the CAS contribution in excess of the tax-deductible limit and any excess could be carried forward to future years for future tax deductibility without penalty. Similarly, if contribution deposits exceeded the CAS computed amounts, the excess funding could be carried forward as a prepayment credit to fund allowable contract costs for future years.

The Tax Reform Act (TRA) of 1986 changed the effect of making pension plan contributions in excess of the tax-deductible limit. The TRA of 1986 imposed an excise tax of 10 percent on contributions in excess of the tax-deductible limit. The excise tax is cumulative from year-to-year and applied on a first-in/first-out basis considering carryforwards and current year contributions.

The Omnibus Budget Reconciliation Act of 1987 added a "current liability" full funding limitation that lowered the tax-deductible limit for many plans, further increasing the conflict between the FAR funding requirement and the excise tax on nondeductible contributions. Many employers could not fund the CAS pension cost without incurring excise tax penalties, yet the FAR stated that unfunded CAS costs could not be carried forward to future years. However, no conflict existed when the tax-deductible maximum equaled or exceeded the CAS pension cost. In that case, the full CAS pension cost could be funded without incurring a penalty, and any decision to fund less than CAS cost was a voluntary financial action.

Revised Cost Accounting Standards

As previously noted, the CAS related to accounting for pension costs was revised on March 30, 1995, and became applicable to contractors with the start of the first accounting period thereafter. The revised CAS removed the regulatory conflict between the funding limits of ERISA of 1974 and the period assignment provisions of the CAS. The transition provisions of the new rule (48 CFR § 9904.412-64) allow the reassignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility. The contracting officer must approve the method or methods used to reassign the unfunded pension costs.

The CAS revision does not remove the requirement to fund pension costs with contributions that are not in conflict with ERISA of 1974. If a contractor could have funded pension costs and chose not to, the costs and any accrued interest are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per the FAR and CAS.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of our review were to:

- determine if the accumulated unfunded pension costs identified in our prior reviews were accounted for properly;

- determine if pension costs for the audit period (1991–2002) were funded in accordance with the FAR and CAS; and

- identify and properly account for any additional accumulated unfunded pension costs, including the identification of the unallowable and reassignable portions of the accumulated unfunded pension costs.

Scope

Our review covered January 1, 1991, to January 1, 2003. Achieving our objectives did not require that we review Anthem's overall internal control structure. However, we did review the controls with regard to the funding of pension costs to ensure that the pension costs had been funded in accordance with the CAS and FAR.

We performed fieldwork at Anthem's office in Louisville, KY, during September 2004, and February 2005.

Methodology

The CMS Office of the Actuary developed the methodology used for computing CAS pension costs based on Anthem's historical practices.

In performing this review, we used information provided by Anthem's actuarial consulting firms. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed Anthem's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s. Using the documents, CMS pension actuarial staff calculated the assignable CAS pension costs for each year 1991 through 2002 for the Medicare segments and the Other segment. Additionally, CMS pension actuarial staff determined the extent to which Anthem funded the pension costs with contributions to the pension trust fund and prepayment credits. The CMS pension actuarial staff also determined the unallowable and reassignable portions of unfunded pension costs. We reviewed the methodology for the calculations and updated Anthem’s unfunded pension costs for 1991 through 2002 for the Medicare segments and the Other segment.

We performed this review in conjunction with our audits of Medicare segmentation of pension assets (A-07-04-00172) and pension costs claimed for Medicare reimbursement (A-07-04-00180 and A-07-05-00194). We used the information obtained and reviewed during those audits in performing this review.

We performed our review in accordance with generally accepted government auditing standards.

FINDING AND RECOMMENDATIONS

Anthem properly accounted for previously identified unfunded pension costs in accordance with Federal regulations. For the current audit period, Anthem funded its pension costs in accordance with the FAR and CAS. However, as a result of the merger with Connecticut, Anthem has unallowable unfunded pension costs for the Other segment. As a former Medicare contractor, Connecticut had unallowable, unfunded pension costs associated with its Other segment. This amount was transferred to Anthem after the merger. As of January 1, 2003, the accumulated unallowable pension costs, attributable to Anthem’s Other segment, are $6,052,895.

For Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with CAS 412 and 413 and (2) funded as specified by part 31 of the FAR. The Medicare contract states: “The calculation of and accounting for pension costs charged to this agreement/contract are governed by the Federal Acquisition Regulation and Cost Accounting Standards 412 and 413.”

Effective January 1, 1996, the revised CAS allows the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility as accumulated reassignable pension costs. However, the revision to CAS does not remove the requirement to fund pension costs when contributions are tax deductible. If a contractor could have funded pension costs and chose not to, the costs and any accrued interest are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per the FAR and CAS.

Anthem’s Other segment includes Connecticut’s unallowable unfunded pension costs. As a result, Anthem has unallowable unfunded pension costs. As of January 1, 2003, Anthem’s accumulated unallowable unfunded pension costs are $6,052,895.

RECOMMENDATIONS

We recommend that Anthem:

- identify $6,052,895 of accumulated unallowable pension costs as of January 1, 2003, and
- identify and properly track unallowable unfunded pension costs in subsequent years.

AUDITEE'S COMMENTS

Anthem agreed with our finding and recommendations and stated that it had already implemented policies and procedures to ensure that unallowable unfunded pension costs were properly tracked in the future. Anthem also provided information to clarify the report background. Anthem's comments are included in their entirety as an appendix.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We commend Anthem for its actions to address the recommendations. We clarified the report background with the information Anthem provided.

APPENDIX

CMS
CENTERS for MEDICARE & MEDICAID SERVICES

Medicare
A Medicare Carrier & Intermediary
T. Jeffrey Hannah
Regional Vice President
Internal Controls and Ethics & Compliance
Phone: (317) 595-4939
Fax: (317) 841-4582

March 31, 2006

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

Attention: Mr. Patrick J. Cogley,
Regional Inspector General for Audit Services

RE: Report Number A-07-06-00205

Dear Mr. Cogley:

Thank you for providing your Draft Report entitled "Audit of Anthem Insurance Company's Unfunded Pension Costs for 1991 through 2002". I write on behalf of Anthem and its subsidiaries, AdminaStar Federal, Inc. ("AdminaStar") and Anthem Health Plans of Maine, Inc. d/b/a Associated Hospital Service ("Maine"), in response to the Draft Report.

The Draft Report makes two recommendations, to which Anthem responds as follows:

1. Recommend that Anthem identify $6,052,895 of accumulated unallowable pension costs as of January 1, 2003.

   Response: Anthem concurs and will follow the recommendation.

2. Recommend that Anthem identify and properly track unallowable unfunded pension costs in subsequent years.

   Response: Anthem concurs and has already implemented processes and procedures designed to properly track these costs.

Anthem also notes the following by way of clarification with regard to the background information in the Draft Report:

The effective date of the merger of Blue Cross Blue Shield of Connecticut, Inc. into Anthem Insurance Companies, Inc. was August 1, 1997.

Thank you for the opportunity to respond to the draft report. Anthem appreciates the courtesy and professionalism demonstrated by the OIG in this audit.

If you have any questions or would like to discuss further, please let me know.

Very truly yours,

T. Jeffrey Hannah / JMH

T. Jeffrey Hannah

Cc: Michael McCarron
Glenn Rhodes
David Crowley
Joanne Imel
Peter McCloud