

**Memorandum**

Date *MAR 22 2000*  
From *for* *Michael Mangano*  
June Gibbs Brown  
Inspector General

Subject Review of Medicare Contractor's Pension Segmentation, Empire Blue Cross Blue Shield (A-07-98-02534)

To Nancy Ann Min DeParle  
Administrator  
Health Care Financing Administration

This is to alert you to the issuance of our final report on Friday, March 24, 2000, in which we determined the Medicare segment pension assets at Empire Blue Cross Blue Shield (Empire) to be \$38.6 million as of January 1, 1999. A copy is attached and copies of the report have been distributed to your staff for adjudication of the finding.

Empire has administered Medicare Parts A and B under cost reimbursement contracts since the start of the Medicare program. Beginning with Fiscal Year 1988, the Health Care Financing Administration incorporated pension segmentation requirements into Medicare contracts. The contractual language specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment.

Our review showed that the Medicare contract segmentation requirements first became applicable to Empire as of January 1, 1999. Prior to that date, Empire's employees were covered under three separate pension plans. The majority of Empire's Medicare segment participants were covered by a fully insured plan which was not subject to the Medicare contract segmentation requirements. Empire replaced their three pension plans with a single plan effective January 1, 1999. This single plan is subject to the Medicare contract segmentation requirements.

We determined the Medicare segment pension assets to be \$38,626,351 as of January 1, 1999. Accordingly, we are recommending that Empire record Medicare segment pension assets of \$38,626,351 as of January 1, 1999. We are also recommending that Empire periodically update the Medicare segment pension assets for contributions, income, benefit payments, and expenses; and compute Medicare pension costs in accordance with the Medicare contract for the period beginning January 1, 1999 and all subsequent periods. Empire agreed with findings and recommendations.

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

Attachment

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE  
CONTRACTOR'S PENSION  
SEGMENTATION, EMPIRE BLUE  
CROSS BLUE SHIELD**



**JUNE GIBBS BROWN**  
**Inspector General**

**MARCH 2000**  
**A-07-98-02534**



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-07-98-02534

Mr. David Jaspen  
AVP, Operations/Medicare  
Empire Blue Cross Blue Shield  
Building: 2 - Floor: 19  
1 World Trade Center  
New York, New York 10048-0682

Dear Mr. Jaspen:

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review entitled, "*Review of Medicare Contractor's Pension Segmentation, Empire Blue Cross Blue Shield.*" The purpose of our review was to evaluate Empire Blue Cross Blue Shield's (Empire) compliance with the pension segmentation requirements of its Medicare contract.

Our review showed that the Medicare contract segmentation requirements first became applicable to Empire as of January 1, 1999. Prior to that date, Empire's employees were covered under three separate pension plans. The majority of Empire's Medicare segment participants were covered by a fully insured plan which was not subject to the Medicare contract segmentation requirements. Empire replaced their three pension plans with a single plan effective January 1, 1999. This single plan is subject to the Medicare contract segmentation requirements. We determined the Medicare segment pension assets to be \$38,626,351 as of January 1, 1999.

We recommend that Empire record Medicare segment pension assets of \$38,626,351 as of January 1, 1999. We also recommending that Empire periodically update the Medicare segment pension assets for contributions, income, benefit payments, and expenses; and compute Medicare pension costs in accordance with the Medicare contract for the period beginning January 1, 1999 and all subsequent periods. Empire agreed with findings and recommendations.

## INTRODUCTION

### BACKGROUND

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

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension 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 Health Care Financing Administration (HCFA) incorporated segmentation requirements into Medicare contracts starting with Fiscal Year 1988. The contractual language specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment.

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

The Medicare contracts identify a Medicare segment as:

*"...any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:*

- 1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or*
- 2. Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract."*

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

To ensure that contractors developed and maintained the data necessary for segmentation calculations, HCFA distributed a pension cost questionnaire to contractors in 1989. Empire's questionnaire response stated that the use of "Medicare segments" was not applicable to their pension program.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

Our objective was to determine Empire's compliance with pension segmentation requirements of its Medicare contract. The audit addressed the initial determination of pension assets for Empire's Medicare segment. Our review covered January 1, 1981 through January 1, 1999.

We made our examination in accordance with generally accepted government auditing standards. Achieving the objective did not require a review of Empire's internal control structure. In performing the review, we used information provided by Empire's consulting actuarial firm. The information included liabilities, normal costs, contributions, expenses, and earnings. We reviewed Empire's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. We also reviewed Empire's identification of the Medicare segment as of January 1, 1999. Using these documents and Empire's identification of the Medicare segment, we calculated the asset fraction, and determined the Medicare segment's initial pension assets.

We performed site work at Empire's corporate offices in New York during December of 1998. Subsequently, we performed audit work in our Jefferson City, Missouri office.

## **FINDING AND RECOMMENDATIONS**

### **MEDICARE ASSETS AS OF JANUARY 1, 1999**

We determined that Empire was not subject to the Medicare contract segmentation requirements until January 1, 1999. Prior to that date the majority of Empire's Medicare segment participants were covered by a plan which was not subject to the segmentation requirements. Empire created a new pension plan effective January 1, 1999 that is subject to the Medicare contract segmentation requirements. We determined the Medicare segment pension assets to be \$38,626,351 as of January 1, 1999.

Empire had three separate pension plans (Plan A, Plan B, and Plan C) prior to January 1, 1999. Historically, about 90 percent of the pension costs that Empire charged to Medicare were attributable to Plan C. Pension Plans A and B were funded and expensed in the traditional manner for defined benefit plans. However, Pension Plan C was funded through a fully insured contract underwritten by an unrelated insurance company. For Plan C, the annual pension expense was determined by the amount of premiums paid, rather than on an actuarial valuation. In accordance with CAS 412-50(a)(6), pension plans such as Plan C are to be treated as defined contribution plans. Empire asserted, and we agree, that the Medicare contract segmentation requirements were not applicable to Plan C.

Empire created a new defined benefit pension plan (Cash Balance Pension Plan) which became effective on January 1, 1999. The new plan was created by the merger of former Plans B and C into the former Plan A. The resulting merged plan was then amended and restated to reflect the conversion to a cash balance formula. We determined, and Empire agreed, that the Medicare contract segmentation requirements are applicable to the Cash Balance Pension Plan.

The Medicare contracts provide for separate identification of the pension assets of the Medicare segment. The identification involves the allocation of assets to the Medicare segment as of the first pension plan year after December 31, 1985 in which the segment first exists. For Empire, that date was January 1, 1999. The allocation is to use the ratio of the actuarial liabilities of the Medicare segment to the actuarial liabilities of the total plan, as of the later of the first day of the first plan year starting after December 31, 1980, or the first day of the first pension plan year following the date such Medicare segment first exists. For Empire, that date was also January 1, 1999.

We determined the Medicare segment pension assets to be \$38,626,351 as of January 1, 1999. The following schedule shows the details of our calculations.

|                 | 1999<br>Total<br>Actuarial<br>Liability<br>(A) | 1999<br>Medicare<br>Actuarial<br>Liability<br>(B) | 1999<br>Rounded<br>Asset<br>Fraction<br>(C)=(B)/(A) | 1999<br>Total<br>Company<br>Assets<br>(D) | 1999<br>Medicare<br>Segment<br>Assets<br>(E)=(C)(D) |
|-----------------|------------------------------------------------|---------------------------------------------------|-----------------------------------------------------|-------------------------------------------|-----------------------------------------------------|
| OIG Calculation | \$278,673,783                                  | \$24,874,772                                      | <u>8.9261%</u>                                      | \$432,734,909                             | <u>\$38,626,351</u>                                 |

**Recommendations:**

We recommend that Empire:

1. Record pension assets of \$38,626,351 for the Medicare segment as of January 1, 1999.
2. Periodically update the Medicare segment pension assets for contributions, income, benefit payments, and expenses; and
3. Compute Medicare pension costs in accordance with the Medicare contract for the period beginning January 1, 1999 and all subsequent periods.

**Auditee Response**

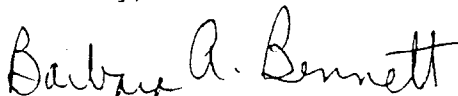
Empire agreed with our recommendations and its response is included in its entirety as Appendix A.

**INSTRUCTIONS FOR AUDITEE RESPONSE**

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

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), Office of Inspector General, Office of Audit Services, reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

Sincerely,



Barbara A. Bennett  
Regional Inspector General for  
Audit Services, Region VII

Enclosures

Page 6 - Mr. David Jaspen

HHS Action Official:

Ms. Judy Berek  
Regional Administrator, Region II  
Health Care Financing Administration  
Jacob K. Javits Federal Building  
26 Federal Plaza, Room 3811  
New York, New York 10278



EMPIRE  
BLUECROSS  
BLUESHIELD

DAVID JASPEN

ASSISTANT VICE PRESIDENT  
MEDICARE QUALITY ASSURANCE  
AND COORDINATION

(212) 476-3825

January 20, 2000

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

Re: CIN: A-07-98-02534

Dear Ms. Bennett:

We have reviewed your office's draft audit report titled *Review of Medicare Contractor's Pension Segmentation, Empire Blue Cross Blue Shield*. We agree with the two recommendations presented.

Specifically:

1. We will establish the value of pension assets at \$38,626,351 for the Medicare segment as of January 1, 1999.
2. We will update the Medicare segment pension assets, and compute Medicare pension costs, in accordance with the Medicare contract for the period beginning January 1, 1999 and all subsequent periods.

We appreciate the assistance that your staff members, as well as HCFA's actuaries, have provided to us to facilitate our understanding of how the pension segmentation requirements apply to our new pension plan.

Sincerely,

A handwritten signature in black ink, appearing to read 'David', followed by a long horizontal stroke.

David Jaspen  
Assistant Vice President

Empire Blue Cross and Blue Shield  
One World Trade Center  
New York NY 10048-0682