

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**NORIDIAN HEALTHCARE
SOLUTIONS, LLC,
UNDERSTATED ITS
MEDICARE SEGMENT
POSTRETIREMENT BENEFIT
ASSETS AS OF JANUARY 1, 2011**

*Inquiries about this report may be addressed to the Office of Public Affairs at
Public.Affairs@oig.hhs.gov.*



Gloria L. Jarmon
Deputy Inspector General

March 2014
A-07-13-00420

Office of Inspector General

<https://oig.hhs.gov/>

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

Noridian Healthcare Solutions, LLC, a Medicare contractor, understated the Medicare segment postretirement benefit plan assets by \$1.1 million as of January 1, 2011.

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) reimburses a portion of contractors' costs for postretirement benefit (PRB) plans. In claiming these costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation and applicable Cost Accounting Standards (CAS). Noridian Healthcare Solutions, LLC (NHS), elected to use segmented accrual accounting for its PRB plans.

We used the Medicare contracts' pension segmentation requirements as authoritative guidance. The fiscal intermediary and carrier contracts require that the pension assets be allocated to each Medicare segment and adjusted in accordance with CAS 413. In turn, CAS 413 requires these contractors to update the pension assets with contributions, permitted unfunded accruals, income, benefit payments (claims paid), participant transfers, and administrative expenses. These PRB assets are calculated by the contractors' actuarial consulting firms and are usually included as CAS exhibits in the contractors' PRB plan actuarial valuation reports. The Medicare segment PRB assets are integral to calculating the allowable Medicare PRB costs.

Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and update the Medicare segment PRB assets. Specifically, our prior PRB segmentation audit of Noridian Mutual Insurance Company (NMIC) (A-07-08-00280) found that NMIC did not correctly identify and update its Medicare segment PRB assets.

The objectives for this review were to determine whether NHS complied with Federal requirements when (1) implementing the prior audit recommendation to increase the Medicare segment PRB assets as of January 1, 2006, and (2) updating the Medicare segment's PRB assets with contributions, permitted unfunded accruals, income, claims paid, participant transfers, and administrative expenses in its CAS exhibits from January 1, 2006, to January 1, 2011.

BACKGROUND

During our audit period, NHS, formerly called Noridian Administrative Services, LLC (NAS), was a subsidiary of NMIC, whose home office was and is in Fargo, North Dakota. NHS administered Medicare Parts A and B and Durable Medical Equipment operations under cost reimbursement contracts with CMS. With the implementation of Medicare contracting reform, NHS continued administering these Medicare operations after receiving the Medicare administrative contractor (MAC) contracts for Jurisdictions D and 3, effective June 30, 2006, and July 31, 2006, respectively. During our audit period, NHS administered both fiscal intermediary and carrier contracts and MAC-related contracts.

Also, effective May 13, 2013, NAS changed its name to NHS. Although we have addressed our report to NMIC, we will associate the term NHS with our findings and recommendations regarding the Medicare segment PRB assets.

NHS participates in a voluntary employee benefit association trust to fund annual PRB accruals. Furthermore, NHS's accounting practice, approved by CMS, uses segmented accrual accounting for its PRB plans.

Our prior PRB segmentation audit (A-07-08-00280, issued August 24, 2009) updated the Medicare segment PRB assets as of January 1, 2006. We recommended that NMIC increase its Medicare segment pension assets by \$2,384,465 and, as a result, recognize \$7,843,111 as the Medicare segment PRB assets as of January 1, 2006, in its CAS exhibits.

WHAT WE FOUND

NHS implemented our prior audit recommendation to recognize \$7,843,111 as the Medicare segment PRB assets as of January 1, 2006, in its CAS exhibits.

Regarding our second objective, NHS identified Medicare segment PRB assets of \$19,009,033 as of January 1, 2011; however, we determined that the Medicare segment PRB assets were \$20,096,041. Therefore, NHS understated the Medicare segment PRB assets by \$1,087,008. NHS understated the Medicare segment PRB assets because it incorrectly identified Medicare segment participants and, therefore, incorrectly identified the Medicare segment contributions and prepayment credits. In addition, NHS lacked controls to ensure that it calculated those assets in accordance with Federal requirements and the pension segmentation language of its Medicare contracts when updating the Medicare segment PRB assets for January 1, 2006, through January 1, 2011.

WHAT WE RECOMMEND

We recommend that NHS:

- increase its Medicare segment PRB assets as of January 1, 2011, by \$1,087,008 and recognize \$20,096,041 as the Medicare segment PRB assets and
- establish controls to ensure compliance with Federal regulations and the Medicare contracts' pension segmentation requirements when updating the Medicare segment PRB assets with contributions, income, claims paid, and expenses.

AUDITEE COMMENTS

In written comments on our draft report, NHS concurred with our recommendations and said that it would increase the Medicare segment PRB assets by \$1,087,008 and that it would recognize \$20,096,041 as the Medicare segment PRB assets as of January 1, 2011. NHS also said that it would ensure that individuals are properly identified to the Medicare segments, that individuals are properly accounted for in transfers and benefit payments, and that the Medicare segment's assets are updated.

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INTRODUCTION

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) reimburses a portion of contractors' costs for postretirement benefit (PRB) plans. In claiming these costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and applicable Cost Accounting Standards (CAS). Noridian Healthcare Solutions, LLC (NHS), elected to use segmented accrual accounting for its PRB plans.

We used the Medicare contracts' pension segmentation requirements as authoritative guidance. The fiscal intermediary and carrier contracts require that the pension assets be allocated to each Medicare segment and adjusted in accordance with CAS 413. In turn, CAS 413 requires these contractors to update the pension assets with contributions, permitted unfunded accruals, income, benefit payments (claims paid), participant transfers, and administrative expenses. These PRB assets are calculated by the contractors' actuarial consulting firms and are usually included as CAS exhibits in the contractors' PRB plan actuarial valuation reports. The Medicare segment PRB assets are integral to calculating the allowable Medicare PRB costs.

Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and update the Medicare segment PRB assets. Specifically, our prior PRB segmentation audit of Noridian Mutual Insurance Company (NMIC) (A-07-08-00280, issued August 24, 2009) found that NMIC did not correctly identify and update its Medicare segment PRB assets.

OBJECTIVES

Our objectives were to determine whether NHS complied with Federal requirements when (1) implementing the prior audit recommendation to increase the Medicare segment PRB assets as of January 1, 2006, and (2) updating the Medicare segment's PRB assets with contributions, permitted unfunded accruals, income, claims paid, participant transfers, and administrative expenses in its CAS exhibits from January 1, 2006, to January 1, 2011.

BACKGROUND

During our audit period, NHS, formerly called Noridian Administrative Services, LLC (NAS), was a subsidiary of NMIC, whose home office was and is in Fargo, North Dakota. NHS administered Medicare Parts A and B and Durable Medical Equipment (DME) operations under cost reimbursement contracts with CMS. With the implementation of Medicare contracting reform, NHS continued administering these Medicare operations after receiving the Medicare administrative contractor (MAC) contracts¹ for Jurisdictions D and 3, effective June 30, 2006,

¹ Section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, P. L. No. 108-173, required CMS to transfer the functions of fiscal intermediaries and carriers to MACs between October 2005 and October 2011. Most, but not all, of the MACs are fully operational; for jurisdictions where the MACs are not fully operational, the fiscal intermediaries and carriers continue to process claims. For purposes of this report, the terms "Medicare contractor" and "MAC" mean the fiscal intermediary, carrier, or MAC, whichever is applicable.

and July 31, 2006, respectively.^{2, 3} During our audit period, NHS administered both fiscal intermediary and carrier contracts and MAC-related contracts.

Also, effective May 13, 2013, NAS changed its name to NHS. Although we have addressed our report to NMIC, we will associate the term NHS with our findings and recommendations regarding the Medicare segment PRB assets.

NHS participates in a voluntary employee benefit association (VEBA) trust for the purpose of funding annual PRB accruals. Furthermore, NHS's accounting practice, approved by CMS, uses segmented accrual accounting for its PRB plans.

Our prior PRB segmentation audit (A-07-08-00280, issued August 24, 2009) updated the Medicare segment PRB assets as of January 1, 2006. We recommended that NMIC increase its Medicare segment pension assets by \$2,384,465 and, as a result, recognize \$7,843,111 as the Medicare segment PRB assets as of January 1, 2006, in its CAS exhibits.

HOW WE CONDUCTED THIS REVIEW

We reviewed NHS's implementation of the prior audit recommendation; identification of its Medicare segment; and update of the Medicare segment PRB assets with contributions, permitted unfunded accruals, income, benefit payments (claims paid), participant transfers, and administrative expenses in its CAS exhibits from January 1, 2006, to January 1, 2011.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix A contains details of our audit scope and methodology.

FINDINGS

NHS implemented our prior audit recommendation to recognize \$7,843,111 as the Medicare segment PRB assets as of January 1, 2006, in its CAS exhibits.

Regarding our second objective, NHS identified Medicare segment PRB assets of \$19,009,033 as of January 1, 2011; however, we determined that the Medicare segment PRB assets were \$20,096,041. Therefore, NHS understated the Medicare segment PRB assets by \$1,087,008. NHS understated the Medicare segment PRB assets because it incorrectly identified Medicare

² DME Jurisdiction D comprises the States of Alaska, Arizona, Hawaii, Idaho, Iowa, Kansas, Missouri, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, and Wyoming, and the territories of American Samoa, Guam, and the Northern Mariana Islands.

³ Medicare Parts A and B Jurisdiction 3 comprises the States of Arizona, Montana, North Dakota, South Dakota, Utah, and Wyoming.

segment participants and, therefore, incorrectly identified the Medicare segment contributions and prepayment credits. In addition, NHS lacked controls to ensure that it calculated those assets in accordance with Federal requirements and the pension segmentation language of its Medicare contracts when updating the Medicare segment PRB assets for January 1, 2006, through January 1, 2011.

Appendix B presents details of NHS’s PRB plan assets from January 1, 2006, to January 1, 2011, as determined during our audit. Table 1 summarizes the audit adjustments required to update NHS’s Medicare segment PRB assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments			
	Per Audit	Per NHS	Difference
Prior Audit Recommendation	\$7,843,111	\$7,843,111	\$0
Update of Medicare Segment Assets			
Contributions and prepayment credits	10,201,356	8,833,185	1,368,171
Claims paid	(960,832)	(547,269)	(413,563)
Investment earnings (net of expenses)	3,012,406	2,880,006	132,400
Understatement of Medicare Segment Assets as of January 1, 2011			\$1,087,008

NORIDIAN HEALTHCARE SOLUTIONS, LLC, IMPLEMENTED OUR PRIOR AUDIT RECOMMENDATION

NHS implemented our prior audit recommendation (A-07-08-00280) that it increase Medicare segment PRB assets by \$2,384,465 and recognize \$7,843,111 of Medicare segment PRB assets as of January 1, 2006, in its CAS exhibits.

UPDATE OF MEDICARE SEGMENT POSTRETIREMENT BENEFIT ASSETS

NHS elected to use segmented accrual accounting for its PRB plans. We used the Medicare contracts’ pension segmentation requirements as authoritative guidance. The Medicare contracts state that “... the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7).”

For details on the Federal requirements, see Appendix C.

The following are our findings regarding the update of the Medicare segment PRB assets from January 1, 2006, to January 1, 2011.

Contributions and Transferred Prepayment Credits Understated

NHS understated contributions and transferred prepayment credits by \$1,368,171 for the Medicare segment because NHS incorrectly calculated the assignable PRB cost on which the

contributions and prepayment credits were based. These incorrect calculations resulted primarily from differences in the identification of Medicare segment participants. Therefore, NHS understated the Medicare segment PRB assets by \$1,368,171.

A comparison of NHS's and our calculations of contributions and transferred prepayment credits for the Medicare segment appears in Table 2.

	Per Audit	Per NHS	Difference
2006	\$3,679,914	\$3,661,783	\$18,131
2007	2,983,797	2,386,464	597,333
2008	2,496,551	2,059,873	436,678
2009	1,041,094	725,065	316,029
2010	0	0	0
Total	\$10,201,356	\$8,833,185	\$1,368,171

Claims Paid Understated

NHS understated claims paid by \$413,563 for the Medicare segment. This understatement occurred primarily because NHS incorrectly identified payments that related to Medicare segment participants. The understatement resulted in an overstatement of the NHS Medicare segment PRB assets by \$413,563.

A comparison of NHS's and our calculations of claims paid for the Medicare segment appears in Table 3.

	Per Audit	Per NHS	Difference
2006	(\$122,184)	(\$166,846)	\$44,662
2007	(148,232)	(31,215)	(117,017)
2008	(207,898)	(72,889)	(135,009)
2009	(233,380)	(140,098)	(93,282)
2010	(249,138)	(136,221)	(112,917)
Total	(\$960,832)	(\$547,269)	(\$413,563)

Investment Earnings (Net of Expenses) Understated

NHS understated investment earnings, less administrative expenses, by \$132,400 for the Medicare segment because it used incorrect contributions and transferred prepayment credits and claims paid (all discussed above) to develop the Medicare segment PRB asset base. In our calculation of the Medicare segment PRB assets as of January 1, 2011, we allocated investment earnings (net of expenses) on the basis of the applicable CAS requirements. For details on applicable Federal requirements, see Appendix C.

RECOMMENDATIONS

We recommend that NHS:

- increase its Medicare segment PRB assets as of January 1, 2011, by \$1,087,008 and recognize \$20,096,041 as the Medicare segment PRB assets and
- establish controls to ensure compliance with Federal regulations and the Medicare contracts' pension segmentation requirements when updating the Medicare segment PRB assets with contributions, income, claims paid, and expenses.

AUDITEE COMMENTS

In written comments on our draft report, NHS concurred with our recommendations and said that it would increase the Medicare segment PRB assets by \$1,087,008 and that it would recognize \$20,096,041 as the Medicare segment PRB assets as of January 1, 2011. NHS also said that it would ensure that individuals are properly identified to the Medicare segments, that individuals are properly accounted for in transfers and benefit payments, and that the Medicare segment's assets are updated. NHS's comments are included in their entirety as Appendix D.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed NHS's implementation of the prior audit recommendation; identification of its Medicare segment; and update of the Medicare segment PRB assets with contributions, permitted unfunded accruals, income, benefit payments (claims paid), participant transfers, and administrative expenses in its CAS exhibits from January 1, 2006, to January 1, 2011.

Achieving our objectives did not require us to review NHS's overall internal control structure. We reviewed controls relating to the identification of the Medicare segment and the update of the Medicare segment's PRB assets.

We performed fieldwork at NHS's office in Fargo, North Dakota, during April and May 2012.

METHODOLOGY

To accomplish our objectives, we took the following steps:

- We reviewed the portions of the FAR, CAS, and the Medicare contracts applicable to this audit.
- We reviewed the annual actuarial valuation reports prepared by NMIC's actuarial consulting firm, which included the PRB plan's assets, PRB obligations, service costs, contributions, claims paid, investment earnings, and administrative expenses. We used this information to calculate the Medicare segment PRB assets.
- We obtained and reviewed the PRB plan documents and Department of Labor/Internal Revenue Service Forms 5500 used in calculating the Medicare segment PRB assets.
- We interviewed NHS staff responsible for determining the methodology that NHS used in its identification of the Medicare segment.
- We reviewed NHS's accounting records to verify the segment identification.
- We reviewed the prior segmentation audit performed at NMIC (A-07-08-00280) to determine the beginning market value of assets.
- We provided the CMS Office of the Actuary with the actuarial information necessary for it to calculate the Medicare segment PRB assets from January 1, 2006, to January 1, 2011.
- We reviewed the CMS actuaries' methodology and calculations.

We performed this review in conjunction with the following audits and used the information obtained during these audits during this review:

- *Noridian Healthcare Solutions, LLC, Claimed Some Unallowable Medicare Postretirement Benefit Costs for Fiscal Years 2006 Through 2010 (A-07-13-00421) and*
- *Noridian Healthcare Solutions, LLC, Understated Its Medicare Segment Allocable Postretirement Benefit Costs and Overstated Its Other Segment Allocable Postretirement Benefit Costs for Calendar Years 2006 Through 2010 (A-07-13-00422).*

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

**APPENDIX B: NORIDIAN HEALTHCARE SOLUTIONS, LLC,
STATEMENT OF MARKET VALUE OF POSTRETIREMENT BENEFIT PLAN
ASSETS FOR THE PERIOD JANUARY 1, 2006, TO JANUARY 1, 2011**

Description		Total Company	Other Segment	Medicare Segment
Assets January 1, 2006	<u>1/</u>	\$15,951,129	\$8,108,018	\$7,843,111
Prepayment credits	<u>2/</u>	0	(671,153)	671,153
Contributions	<u>3/</u>	7,500,000	4,491,239	3,008,761
Claims paid	<u>4/</u>	(843,115)	(720,931)	(122,184)
Investment return	<u>5/</u>	1,939,186	939,667	999,519
Assets January 1, 2007		\$24,547,200	\$12,146,840	\$12,400,360
Prepayment credits		0	0	0
Contributions		8,100,000	5,116,203	2,983,797
Claims paid		(869,320)	(721,088)	(148,232)
Investment return		1,070,637	542,642	527,995
Assets January 1, 2008		\$32,848,517	\$17,084,597	\$15,763,920
Prepayment credits		0	0	0
Contributions		7,000,000	4,503,449	2,496,551
Claims paid		(932,722)	(724,824)	(207,898)
Investment return		(7,323,271)	(3,907,069)	(3,416,202)
Assets January 1, 2009		\$31,592,524	\$16,956,153	\$14,636,371
Prepayment credits		0	(46,470)	46,470
Contributions		3,000,000	2,005,376	994,624
Claims paid		(1,084,806)	(851,426)	(233,380)
Investment return		6,418,198	3,468,111	2,950,087
Assets January 1, 2010		\$39,925,916	\$21,531,744	\$18,394,172
Prepayment credits		0	0	0
Contributions		0	0	0
Claims paid		(1,099,690)	(850,552)	(249,138)
Investment return		4,234,805	2,283,798	1,951,007
Assets January 1, 2011		\$43,061,031	\$22,964,990	\$20,096,041
Per NHS	<u>6/</u>	43,061,031	24,051,998	19,009,033
Asset variance	<u>7/</u>	0	1,087,008	(1,087,008)

ENDNOTES

- 1/ We determined the Medicare segment PRB assets as of January 1, 2006, based on our prior segmentation audit of NMIC (A-07-08-00280). The amounts shown for the Other segment represent the difference between the Total Company and the Medicare segment. All PRB assets are shown at market value.
- 2/ Prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current-year contributions to avoid incurring unallowable interest. Prepayment credits are transferred to the Medicare segment as needed to cover funding requirements.
- 3/ We obtained Total Company contribution amounts from the actuarial valuation reports and VEBA trust statements. We allocated Total Company contributions to the Medicare segment based on the ratio of the Medicare segment funding target divided by the Total Company funding target. Contributions in excess of the funding targets were treated as prepayment credits and accounted for in the Other segment until needed to fund PRB costs in the future. The amounts represent funds deposited in the trust.
- 4/ Claims paid represents benefits reimbursements from the trust fund for claims paid. We obtained Medicare segment claims paid amounts from documents prepared by NHS's actuarial consulting firms.
- 5/ We obtained investment returns from the PRB actuarial valuation reports. We allocated net investment returns based on the ratio of the segment's weighted average value (WAV) of assets to Total Company WAV of assets as required by the CAS.
- 6/ We obtained the asset amount as of January 1, 2011, from NHS's actuarial consulting firms.
- 7/ The asset variance represents the difference between our calculation of the Medicare segment PRB assets and NHS's calculation of the Medicare segment PRB assets.

APPENDIX C: FEDERAL REQUIREMENTS RELATED TO POSTRETIREMENT BENEFIT SEGMENTATION

FEDERAL REGULATIONS

FAR 31.205-6(o) requires that, to be allowable for Medicare reimbursement, PRB accrual costs be (1) measured and assigned in accordance with generally accepted accounting principles; (2) funded in a dedicated trust fund, such as a VEBA trust; and (3) calculated in accordance with generally accepted actuarial principles and practices as promulgated by the Actuarial Standards Board.

CAS 412.50(a)(4) requires that contributions in excess of the pension cost assigned to the period be recognized as prepayment credits and accumulated at the assumed valuation interest rate until applied to future-period costs. Prepayment credits that have not been applied to fund pension costs are excluded from the value of assets used to compute pension costs.

CAS 413.50(c)(7) requires that the asset base be updated by contributions, permitted unfunded accruals, income, benefit payments, and expenses. For plan years beginning after March 30, 1995, the CAS requires investment income and expenses to be allocated among segments on the basis of the ratio of the segment's WAV of assets to the Total Company WAV of assets.

MEDICARE CONTRACTS

The fiscal intermediary and carrier 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 are charged to the Medicare agreement/contract, and these salary dollars represent 40% or more of the total salary dollars charged to the Medicare agreement/contract.

Furthermore, the fiscal intermediary and carrier contracts state that "... the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7)."

APPENDIX D: AUDITEE COMMENTS



February 6, 2014

Mr. Patrick J. Cogley
Regional Inspector General for Audit Services
Office of Audit Services, Region VII
601 East 12th Street, Room 0429
Kansas City, MO 64106

Re: Report A-07-13-00420

Dear Mr. Cogley,

We have reviewed your draft report entitled *Noridian Healthcare Solutions, LLC, Understated Its Medicare Segment Postretirement Benefit Assets as of January 1, 2011* and offer the following comments:

Recommendations:

- Increase its Medicare segment PRB assets as of January 1, 2011, by \$1,087,008 and recognize \$20,096,041 as the Medicare segment PRB assets.
 - We concur with this recommendation and will increase its Medicare segment PRB assets as of January 1, 2011, by \$1,087,008 and recognize \$20,096,041 as the Medicare segment PRB assets.
- Establish controls to ensure compliance with Federal regulations and the Medicare contracts' pension segmentation requirements when updating the Medicare segment PRB assets with contributions, income, claims paid, and expenses.
 - We concur with this recommendation and will ensure that individuals are properly identified to the Medicare segment, individuals are properly accounted for on transfer and benefit payment schedules, and Medicare segment's assets are updated.

Sincerely,

A handwritten signature in black ink, appearing to read "B. Fellner".

Brian Fellner
Enterprise Vice President and Chief Financial Officer