



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

OCT 19 2006

Report Number: A-07-06-00197

Mark Stimpson, Vice President Medicare Northwest
2890 East Cottonwood Parkway
P.O. Box 30270
Salt Lake City, Utah 84130

Dear Mr. Stimpson:

Enclosed are two copies of the U.S. Department of Health and Human Services, Office of Inspector General (OIG) report entitled "Review of Medicare Contractor's Pension Segmentation Requirements at Blue Cross Blue Shield of Oregon for the Period January 1, 1994, through January 1, 1997." A copy of this report will be forwarded to the HHS action official noted on the next page for his review and any action deemed necessary.

The HHS action official will make final determination regarding actions taken on all matters in the report. 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, extension 274, or Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through email at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-06-00197 in all correspondence.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Patrick J. Cogley".

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Mr. RJ Ruff
Regional Administrator, Region X
Centers for Medicare & Medicaid Services
2201 Sixth Avenue, MS-40
Seattle, Washington 98121

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF MEDICARE
CONTRACTOR'S PENSION
SEGMENTATION REQUIREMENTS
AT BLUE CROSS BLUE SHIELD
OF OREGON FOR THE PERIOD
JANUARY 1, 1994, THROUGH
JANUARY 1, 1997**



Daniel R. Levinson
Inspector General

October 2006
A-07-06-00197

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

Blue Cross Blue Shield of Oregon (Oregon) administered Medicare Part A under a cost reimbursement contract with Centers for Medicare & Medicaid Services (CMS) until it merged with King County Medical Blue Shield, Pierce County Medical Bureau, and Medical Service Bureau of Idaho on January 1, 1997 to form The Regence Group (TRG). Each of these four entities maintained a separate qualified defined benefit pension plan. Effective January 1, 1997, TRG merged these four plans to form The Regence Group Retirement Plan. Oregon also serves as the Common Working File Host for the Great Western Sector under a separate cost reimbursable contract.

Starting with fiscal year 1988, CMS incorporated segmentation requirements into Medicare contracts. The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the segment. Additionally, the contract requires Medicare segment assets to be updated for each year after the initial allocation in accordance with Cost Accounting Standards 412 and 413.

OBJECTIVES

Our objectives were to determine if Oregon complied with the Medicare contracts' pension segmentation requirements while:

- implementing the prior audit recommendation, and
- updating the Medicare segment's assets from January 1, 1994, through January 1, 1997.

SUMMARY OF FINDINGS

Oregon did correctly implement the prior audit recommendation; however, it did not comply with the Medicare contract's pension segmentation requirements when updating the segment's assets from January 1, 1994, through January 1, 1997. As a result, Oregon overstated the January 1, 1997, Medicare segment assets by \$298,048.

RECOMMENDATION

We recommend that Oregon decrease Medicare segment pension assets by \$298,048 as of January 1, 1997.

AUDITEE'S COMMENTS

Oregon agreed with our recommendation. Oregon's response is included in its entirety as Appendix B.

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Glossary of Abbreviations and Acronyms

Oregon	Blue Cross Blue Shield of Oregon
CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
CWFH	Common Working File Host
OIG	Office of Inspector General
TRG	The Regence Group

INTRODUCTION

BACKGROUND

Oregon's Medicare Contract

Blue Cross Blue Shield of Oregon (Oregon) administered Medicare Part A under a cost reimbursement contract with Centers for Medicare & Medicaid Services (CMS) until it merged with King County Medical Blue Shield, Pierce County Medical Bureau, and Medical Service Bureau of Idaho on January 1, 1997 to form The Regence Group (TRG). Each of these four entities maintained a separate qualified defined benefit pension plan. Effective January 1, 1997, TRG merged these four plans to form The Regence Group Retirement Plan. Oregon also serves as the Common Working File Host for the Great Western Sector under a separate cost reimbursable contract.

CMS incorporated segmentation requirements into Medicare contracts starting in fiscal year 1988. The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the segment. Furthermore, the contract requires Medicare segment assets to be updated for each year after the initial asset allocation in accordance with Cost Accounting Standards (CAS) 412 and 413. Finally, in claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation, CAS, and Medicare contract.

Regulations

The CAS 412 regulates the determination and measurement of pension cost components. 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.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to determine if Oregon complied with the Medicare contracts' pension segmentation requirements while:

- implementing the prior audit recommendation, and
- updating the Medicare segment's assets from January 1, 1994, through January 1, 1997.

Scope

We reviewed Oregon's identification of its Medicare segment and its update of Medicare assets from January 1, 1994, through January 1, 1997.

Achieving our objectives did not require us to review Oregon's overall internal control structure. However, we did review controls relating to the identification of the Medicare segment and the update of the segment assets to ensure adherence to the Medicare contract, CAS 412, and CAS 413.

We performed fieldwork at Oregon's office in Portland, Oregon, during November 2005.

Methodology

In performing this review, we used information provided by Oregon's prior and current actuarial consulting firms. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. Oregon was unable to provide the accrued liabilities and normal costs by participant for the year 1995; however, after analysis of the data, we were able to accept the Medicare segment accrued liabilities and normal costs as identified by Oregon. We reviewed Oregon's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s. In addition, the CMS Office of the Actuary staff used the documents to calculate Medicare segment assets as of January 1, 1997. We reviewed the methodology and calculations.

We performed this review in conjunction with our audit of the pension costs Oregon claimed for Medicare reimbursement (A-07-06-00214). We used the information obtained and reviewed during that audit in performing this review.

Details of the Medicare segment's updated pension assets from January 1, 1994, through January 1, 1997, are presented as Appendix A.

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

FINDINGS AND RECOMMENDATION

Oregon properly implemented the prior audit recommendation as of January 1, 1994; however, Oregon did not comply with the Medicare contract's pension segmentation requirements while updating Medicare segment assets from January 1, 1994, through January 1, 1997.

As a result, Oregon overstated the January 1, 1997, Medicare segment pension assets by \$298,048. The accumulated overstatement of Medicare segment assets is shown in Table 1.

Table 1: Summary of Asset Adjustments	
Contributions and Prepayment Credits	\$30,844
Net Transfers	(154,613)
Earnings and Expenses	(174,279)
(Over)/Understatement	(\$298,048)

MEDICARE CONTRACT AND COST ACCOUNTING STANDARDS

Medicare Contract

The Medicare contract identifies 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.

Furthermore, the Medicare contract states that: “. . . the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7).”

Cost Accounting Standards

The CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses. For plan years beginning on or before March 30, 1995, the CAS requires investment income and expenses to be allocated among segments in proportion to the beginning of year asset value. For plan years beginning after March 30, 1995, the CAS requires investment income and expenses to be allocated among segments based on the ratio of the segment’s weighted average value method (WAV) of assets to total company WAV of assets.

In addition, CAS 413.50(c)(8) requires an adjustment to be made for transfers (participants who enter or leave the segment) if the transfers materially affect the segment’s ratio of pension plan assets to actuarial accrued liabilities.

Furthermore, CAS 412.50(a)(4) provides that contributions in excess of the pension cost assigned to the period are recognized as prepayment credits and are 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.

PRIOR AUDIT RECOMMENDATION

Oregon did implement the recommendation from the prior segmentation report (A-07-95-01150), which recommended that Oregon increase assets by \$191,312 and recognize Medicare segment assets of \$1,357,111 as of January 1, 1994.

UPDATE OF MEDICARE SEGMENT ASSETS

Oregon did not properly account for contributions and prepayment credits, transfers, earnings, and expenses while updating the segment’s assets from January 1, 1994, through January 1, 1997.

Contributions and Prepayment Credits Understated

Oregon’s update methodology did not equitably assign pension contributions to the Medicare segment because Oregon did not correctly identify the Medicare segment. The differences in the development of segment assets in 1995 and 1996 led to incorrect allocation of funding to the Medicare segment. As a result, Oregon understated contribution and prepayments by \$30,844.

The audited contributions and prepayment credits are based on the assignable pension costs as calculated by the CMS Office of the Actuary. The differences in asset values in 1995 and 1996 caused differences in the assignable pension costs, resulting in differences in contribution and prepayment allocations.

The segment assets increased by \$30,844 in the audited update due to differences in assigned contributions and prepayment credits. A comparison of Oregon’s and our calculations of allocated pension contributions and prepayment credits is shown in Table 2.

Year	OIG	Oregon	Difference
1994	\$117,975	\$117,975	\$0
1995	898	40,752	(39,854)
1996	145,739	75,041	70,698
Total	\$264,612	\$233,768	\$30,844

¹Since the prior segmentation report (A-07-95-01150), the presentation of the prepayment credit has changed to maintain the accumulated prepayment credit outside of the Medicare segment except to cover assigned pension costs. The prepayment credits that were carried forward in the Medicare segment from the prior audit were used prior to using the prepayment credits carried in the other segment; thus no prepayment credits resided in the Medicare segment as of January 1, 1997.

Net Transfers Understated

Oregon understated transfers out of the Medicare segment by \$154,613. It made adjustments for transfers in its update of segment assets from January 1, 1994, through January 1, 1997. However, Oregon incorrectly identified the participants who transferred in and out of the segment. As a result, Oregon overstated its Medicare segment assets by \$154,613.

A comparison of Oregon's and our calculations of net asset transfers from the Medicare segment is shown in Table 3.

Year	OIG	Oregon	Difference
1994	(\$53,180)	\$356,815	(\$409,995)
1995	(141,572)	(140,834)	(738)
1996	(20,576)	(276,696)	256,120
Total	(\$215,328)	(\$60,715)	(\$154,613)

Earnings and Expenses Overstated

Oregon overstated investment earnings, less administrative expenses, by \$174,279 for the Medicare segment because it used incorrect contribution, prepayment credit, and transfer amounts (discussed above) in the development of the Medicare segment asset balances, which were the basis for allocating investment earnings and expenses. In our audited update, we allocated earnings and expenses based upon the applicable CAS requirements.

OVERSTATEMENT OF MEDICARE SEGMENT ASSETS

Oregon did not ensure that the Medicare segment's assets were updated in accordance with the Medicare contract. As of January 1, 1997, Oregon overstated Medicare segment pension assets by \$298,048.

RECOMMENDATION

We recommend that Oregon decrease Medicare segment pension assets by \$298,048 as of January 1, 1997.

AUDITEE'S COMMENTS

Oregon agreed with our recommendation. Oregon's response is included in its entirety as Appendix B.

APPENDIXES

Blue Cross Blue Shield of Oregon
Statement of Market Value of Pension Assets
For the Period
January 1, 1994, through January 1, 1997

APPENDIX A
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Description		Total Company	Other Segment	Medicare
Assets January 1, 1994	<u>1/</u>	\$32,197,220	\$30,840,109	\$1,357,111
Prepayment Transfer		0	0	0
Contributions	<u>2/</u>	4,163,440	4,045,465	117,975
Earnings	<u>3/</u>	199,468	191,060	8,408
Benefit Payments	<u>4/</u>	(1,808,518)	(1,808,518)	0
Expenses	<u>5/</u>	(167,858)	(160,782)	(7,076)
Transfers	<u>6/</u>	0	53,180	(53,180)
Assets January 1, 1995		34,583,752	33,160,514	1,423,238
Prepayment Transfer	<u>7/</u>	0	(898)	898
Contribution		4,166,179	4,166,179	0
Earnings		9,150,067	8,773,273	376,794
Benefit Payments		(2,399,448)	(2,399,448)	0
Expenses		(168,187)	(161,261)	(6,926)
Transfers		0	141,572	(141,572)
Assets January 1, 1996		45,332,363	43,679,931	1,652,432
Prepayment Transfer		0	(145,739)	145,739
Contribution		3,966,334	3,966,334	0
Earnings		7,421,641	7,130,193	291,448
Benefit Payments		(1,646,990)	(1,646,990)	0
Expenses		(234,120)	(224,926)	(9,194)
Transfers		0	20,576	(20,576)
Other Transaction	<u>8/</u>	54,013,035	54,013,035	0
Assets January 1, 1997		\$108,852,263	\$106,792,414	\$2,059,849
Per Oregon	<u>9/</u>	\$108,852,263	\$106,494,366	\$2,357,897
Asset Variance	<u>10/</u>	\$0	\$298,048	(\$298,048)

FOOTNOTES

1/ We determined the Medicare segment assets as of January 1, 1994, based upon our prior segmentation audit (A-07-95-01150). The amounts shown for the other segment represent the difference between the total company and the Medicare segment. All pension assets are shown at market value.

Blue Cross Blue Shield of Oregon
Statement of Market Value of Pension Assets
For the Period
January 1, 1994, through January 1, 1997

APPENDIX A
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- 2/ We obtained total company contribution amounts from the actuarial valuation reports and Department of Labor/Internal Revenue Service Form 5500s. 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 prepayments credits and accounted for in the other segment until needed to fund pension cost in the future.
- 3/ We obtained investment earnings from actuarial valuation reports. We allocated investment earnings based on the market value of Medicare assets at the beginning of the plan year after adjustment for transfers. For years starting with 1996, we allocated investment earnings based on the ratio of the segment's Weighted Average Value (WAV) of assets to total company WAV of assets as required by the Cost Accounting Standards (CAS).
- 4/ We based the Medicare segment's benefit payments on actual payments to Medicare retirees. Oregon provided us with supporting documentation for benefit payment amounts to plan retirees. We used actual benefit payments for Medicare segment retirees.
- 5/ We allocated administrative expenses to the Medicare segment in proportion to investment earnings.
- 6/ We identified participant transfers between segments by comparing valuation data files provided by Oregon. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. For transfers that occurred prior to the 1996 plan year, asset transfers reflected the funding level of the segment from which the participant transferred, based on the actuarial liability and the asset value used for cost purposes. We calculated the funding level as the assets divided by the liabilities. If the funding level was greater than one, we transferred assets equal to the participant's liability. For plan years starting with 1996, asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with the CAS.
- 7/ Prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current year contributions in order to reduce interest costs to the Federal Government. Prepayment credits are transferred to the Medicare segment at the first of the year as needed to cover funding requirements.
- 8/ The other transaction represents the merger of assets from the King County Medical Blue Shield, Pierce County Medical Bureau, and Medical Service Bureau of Idaho pension plans into the Oregon pension plan as of January 1, 1997. This transfer in of assets involved business units outside the Medicare segment and therefore does not affect the Medicare segment.

Blue Cross Blue Shield of Oregon
Statement of Market Value of Pension Assets
For the Period
January 1, 1994, through January 1, 1997

APPENDIX A
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9/ We obtained total asset amounts as of January 1, 1997, from the actuarial valuation report as prepared by Oregon's actuarial consulting firm.

10/ The asset variance represents the difference between our calculation of Medicare segment assets and Oregon's market value of assets.



October 11, 2006

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Patrick J. Cogley
Regional Inspector General for Audit Services Region VII
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Kansas City, Missouri 64106

Dear Mr. Cogley

RE: Audit Response

We have reviewed the referenced draft audit reports and include the following written comments for your consideration:

Report Number: A-07-06-00197

Summary of Findings:

Oregon did correctly implement the prior audit recommendation; however it did not comply with the Medicare contract's pension segmentation requirements when updating the segment's assets from January 1, 1994, through January 1, 1997. As a result, Oregon overstated the January 1, 1997 Medicare segment assets by \$298,048.

Recommendation:

We recommend that Oregon decrease Medicare segment pension assets by \$298,048 as of January 1, 1997.

Regence Response:

We agree with the recommendation. Regence BlueCross and BlueShield of Oregon terminated its Medicare Part A contract effective November 30, 2005.

Report Number: A-07-06-00214

Summary of Findings:

Oregon failed to claim \$136,186 of allowable Medicare Part A pension cost due to an adjustment made to pension costs from an administrative cost audit. Oregon claimed \$25,552 of pension costs for Medicare reimbursement; however we calculated the allowable Medicare pension costs during this period to be \$161,738.

Patrick J. Cogley
October 11, 2006
Page 2 _____

Recommendation:

We recommend that Oregon revise its Final Administrative Cost Proposal to claim the allowable Medicare Part A CAS pension cost of \$136,186 for FY 1996.

Regence Response:

We agree with the recommendation. Regence BlueCross and BlueShield of Oregon terminated its Medicare Part A contract effective November 30, 2005 and will include allowable pension cost of \$136,186 as a part of our global settlement with CMS.

Sincerely,



R Paul Warburton
Director of Finance