



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Offices of Audit Services

AUG 31 2006

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

Report Number: A-07-06-00216

Karen Abraham, Vice President of Finance  
PO Box 13446  
8220 N 23<sup>rd</sup> Avenue  
Phoenix, Arizona 85021

Dear Ms. Abraham:

Enclosed are two copies of the U.S. Department of Health and Human Services, Office of Inspector General report entitled "Review of Pension Costs Claimed for Medicare Reimbursement by Blue Cross Blue Shield of Arizona for Fiscal Years 1991 Through 2005." 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 action 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.

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 are made available to the public to the extent information contained therein is not subject to exemptions in the Act (see 45 CFR part 5).

If you have any questions or comments about this report, please do not hesitate to contact me at (816) 426-3591, extension 274 or Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through e-mail at [Jenenne.Tambke@oig.hhs.gov](mailto:Jenenne.Tambke@oig.hhs.gov). Please refer to report number A-07-06-00216 in all correspondence.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Patrick J. Cogley", written over a large, stylized flourish.

Patrick J. Cogley  
Regional Inspector General  
for Audit Services

Enclosures

Page 2 – Ms. Karen Abraham

**Direct Reply to HHS Action Official:**

Mr. Jeff Flick  
Regional Administrator, Region IX  
Centers for Medicare & Medicaid Services  
75 Hawthorne Street, Suite 408  
San Francisco, California 94105

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF PENSION COSTS  
CLAIMED FOR MEDICARE  
REIMBURSEMENT BY BLUE  
CROSS BLUE SHIELD OF  
ARIZONA FOR FISCAL YEARS  
1991 THROUGH 2005**



Daniel R. Levinson  
Inspector General

August 2006  
A-07-06-00216

# *Office of Inspector General*

<http://oig.hhs.gov>

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The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

## *Office of Audit Services*

The Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

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# *Notices*

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## **THIS REPORT IS AVAILABLE TO THE PUBLIC** at <http://oig.hhs.gov>

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR Part 5.)

## **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**

Arizona administers Medicare Part A operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services.

Medicare reimburses a portion of the annual contributions that contractors make to their pension plans. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations, Cost Accounting Standards, and Medicare contracts.

The Medicare contracts require contractors to allocate or separately calculate pension costs. Contractors must use the separate calculation method if there is a material difference between the results of the two methods.

### **OBJECTIVE**

Our objective was to determine the allowability of pension costs claimed by Arizona for Medicare reimbursement for fiscal years (FY) 1991 through 2005.

### **SUMMARY OF FINDING**

Arizona claimed \$142,343 of unallowable Medicare pension costs for FYs 1991 through 2005 due to the differences in the calculated allocable pension costs. Arizona claimed \$1,737,918 of pension costs for Medicare reimbursement; however we calculated the allowable Medicare pension costs during this period to be \$1,595,575.

### **RECOMMENDATION**

We recommend that Arizona revise its Final Administrative Cost Proposals for FYs 1991 through 2005 to reduce its claimed pension costs by \$142,343.

### **AUDITEE'S COMMENTS**

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

## **INTRODUCTION**

### **BACKGROUND**

#### **Arizona's Medicare Contract**

Arizona administers Medicare Part A operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS).

Medicare reimburses a portion of the annual contributions that contractors make to their pension plans. To be allowable for Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with Cost Accounting Standards (CAS) 412 and 413; and (2) funded as specified by part 31 of the Federal Acquisition Regulations (FAR).

Beginning in fiscal year (FY) 1988, CMS incorporated specific segmentation language into Medicare contracts that requires contractors to use either an allocation method or a separate calculation method to identify and claim pension costs for Medicare reimbursement. Under the allocation method, the contractor determines total plan CAS pension costs and allocates a share to Medicare. Under the separate calculation method, the contractor separately identifies the pension cost components for the Medicare segment. The contractor must use the separate calculation method if its result is materially different from that of the allocation method.

#### **Regulations**

The Medicare contract addresses the determination and allocation of pension costs. Appendix B, section XVI, of the 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."

The FAR 31.205-6(j) addresses allowability of pension costs and requires that plan contributions substantiate pension costs assigned to contract periods.

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.

## **Scope**

We reviewed pension costs that Arizona claimed for Medicare reimbursement on its Final Administrative Cost Proposals (FACPs) for FYs 1991 through 2005. Achieving the objective did not require that we review Arizona's overall internal control structure. However, we did review the internal controls related to the pension costs claimed for Medicare reimbursement to ensure that the pension costs were allocable in accordance with the CAS and allowable in accordance with the FAR.

We performed fieldwork at Arizona's office in Phoenix, Arizona, during March 2006.

## **Methodology**

We identified Arizona's CAS pension costs for the total company and the Medicare segment. We also determined the extent to which Arizona funded CAS pension costs with contributions to the pension trust fund and accumulated prepayment credits. Using this information, we calculated CAS pension costs that were allowable for Medicare reimbursement for FYs 1991 through 2005. The calculations were based on separately computed CAS pension costs for the Medicare segment and total company CAS pension costs. The CMS Office of the Actuary calculated the allocable CAS pension costs based on Arizona's historical practices and on the results of our segmentation review ("Review of Medicare Contractor's Pension Segmentation Requirements at Blue Cross Blue Shield of Arizona, for the Period January 1, 1991, to January 1, 2005," A-07-06-00207). Appendix A contains details on the pension costs and contributions.

In performing our review, we used information that Arizona's actuarial consulting firms provided. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. Arizona was unable to provide the accrued liabilities and normal costs by participant for the years 1992 through 1994; however we were able to accept the Medicare segment accrued liabilities and normal costs as identified by Arizona. We examined Arizona's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s.

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

## FINDING AND RECOMMENDATION

Arizona claimed \$142,343 of unallowable Medicare pension costs for FYs 1991 through 2005.

We calculated the allowable pension costs based on separately computed CAS pension costs for the Medicare segment and total company CAS pension costs. We compared allowable CAS pension costs with the pension costs claimed on Arizona's FACPs, as shown in the table below.

<b>Pension Cost Claimed Variance</b>			
<b>Fiscal Year</b>	<b>Per OIG</b>	<b>Per Arizona</b>	<b>Difference</b>
<b>1991</b>	\$14,453	\$68,364	(\$53,911)
<b>1992</b>	17,287	38,792	(21,505)
<b>1993</b>	19,191	44,191	(25,000)
<b>1994</b>	90,210	101,742	(11,532)
<b>1995</b>	42,447	67,271	(24,824)
<b>1996</b>	23,559	41,384	(17,825)
<b>1997</b>	29,077	25,313	3,764
<b>1998</b>	26,192	28	26,164
<b>1999</b>	7,285	0	7,285
<b>2000</b>	51,007	46,551	4,456
<b>2001</b>	146,788	140,551	6,237
<b>2002</b>	193,461	205,442	(11,981)
<b>2003</b>	272,976	301,007	(28,031)
<b>2004</b>	310,047	299,469	10,578
<b>2005</b>	351,595	357,813	(6,218)
<b>Total</b>	<b>\$1,595,575</b>	<b>\$1,737,918</b>	<b>(\$142,343)</b>

For FYs 1991 through 2005, Arizona claimed pension costs of \$1,737,918 for Medicare reimbursement; however, allowable CAS pension costs were \$1,595,575. Therefore, Arizona claimed \$142,343 of unallowable pension costs due to the differences in the allocable pension costs. The differences occurred due to the differences in the asset base and it did not properly apply the accumulated cost limitation to the pension costs calculation as required by the CAS.

## **RECOMMENDATION**

We recommend that Arizona revise its FACPs for FYs 1991 through 2005 to reduce its claimed pension costs by \$142,343.

## **AUDITEE'S COMMENTS**

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

# APPENDIXES

**BLUE CROSS BLUE SHIELD OF ARIZONA  
STATEMENT OF ALLOWABLE PENSION COSTS  
FOR FISCAL YEARS 1991 THROUGH 2005**

Date	Description		Total Company	Other Segment	Medicare Segment
1990	Contributions	<u>1/</u>	\$154,566	\$153,583	\$983
9.00%	Discount For Interest	<u>2/</u>	0	0	0
	Present Value Contributions	<u>3/</u>	154,566	153,583	983
	Prepayment Credit	<u>4/</u>	0	0	0
	Present Value Of Funding	<u>5/</u>	154,566	153,583	983
	CAS Funding Target	<u>6/</u>	554,402	550,877	3,525
	Percentage Funded	<u>7/</u>		27.88%	27.89%
	Funded Pension Cost	<u>8/</u>		153,585	983
	Allowable Interest	<u>9/</u>		0	0
	Allocable Pension Cost	<u>10/</u>		153,585	983
1990	Fiscal Year Pension Cost			N/A	N/A
	Medicare LOB* Percentage			N/A	N/A
	Allowable Pension Cost		N/A	N/A	N/A

1991	Contributions		\$963,861	\$963,861	\$0
9.00%	Discount For Interest		(75,494)	(75,494)	0
	Present Value Contributions		888,367	888,367	0
	Prepayment Credit		0	0	0
	Present Value Of Funding		888,367	888,367	0
	CAS Funding Target		579,211	579,211	0
	Percentage Funded			100.00%	0.00%
	Funded Pension Cost			579,211	0
	Allowable Interest			36,925	0
	Allocable Pension Cost			616,136	0
1991	Fiscal Year Pension Cost	<u>11/</u>		500,498	246
	Medicare LOB Percentage	<u>12/</u>		2.84%	97.11%
	Allowable Pension Cost	<u>13/</u>	<u>\$14,453</u>	<u>\$14,214</u>	<u>\$239</u>

**BLUE CROSS BLUE SHIELD OF ARIZONA  
STATEMENT OF ALLOWABLE PENSION COSTS  
FOR FISCAL YEARS 1991 THROUGH 2005**

Date	Description	Total Company	Other Segment	Medicare Segment
1992	Contributions	\$680,588	\$680,588	\$0
9.00%	Discount For Interest	(24,541)	(24,541)	0
	Present Value Contributions	656,047	656,047	0
	Prepayment Credit	336,980	336,980	0
	Present Value Of Funding	993,027	993,027	0
	CAS Funding Target	564,791	564,791	0
	Percentage Funded		100.00%	0.00%
	Funded Pension Cost		564,791	0
	Allowable Interest		8,522	0
	Allocable Pension Cost		573,313	0
1992	Fiscal Year Pension Cost		584,019	0
	Medicare LOB Percentage		2.96%	97.67%
	Allowable Pension Cost	<u>\$17,287</u>	<u>\$17,287</u>	<u>\$0</u>

1993	Contributions	\$1,400,054	\$1,400,054	\$0
8.50%	Discount For Interest	(84,828)	(84,828)	0
	Present Value Contributions	1,315,226	1,315,226	0
	Prepayment Credit	466,777	466,777	0
	Present Value Of Funding	1,782,003	1,782,003	0
	CAS Funding Target	918,942	918,942	0
	Percentage Funded		100.00%	0.00%
	Funded Pension Cost		918,942	0
	Allowable Interest		27,224	0
	Allocable Pension Cost		946,166	0
1993	Fiscal Year Pension Cost		852,953	0
	Medicare LOB Percentage		2.25%	98.93%
	Allowable Pension Cost	<u>\$19,191</u>	<u>\$19,191</u>	<u>\$0</u>

**BLUE CROSS BLUE SHIELD OF ARIZONA  
STATEMENT OF ALLOWABLE PENSION COSTS  
FOR FISCAL YEARS 1991 THROUGH 2005**

Date	Description	Total Company	Other Segment	Medicare Segment
1994	Contributions	\$1,865,996	\$1,841,936	\$24,060
8.00%	Discount For Interest	(95,885)	(94,649)	(1,236)
	Present Value Contributions	1,770,111	1,747,287	22,824
	Prepayment Credit	936,421	871,176	65,245
	Present Value Of Funding	2,706,532	2,618,463	88,069
	CAS Funding Target	1,264,008	1,175,939	88,069
	Percentage Funded		100.00%	100.00%
	Funded Pension Cost		1,175,939	88,069
	Allowable Interest		16,509	1,236
	Allocable Pension Cost		1,192,448	89,305
1994	Fiscal Year Pension Cost		1,130,878	66,979
	Medicare LOB Percentage		2.13%	98.72%
	Allowable Pension Cost	<u>\$90,210</u>	<u>\$24,088</u>	<u>\$66,122</u>

1995	Contributions	\$1,927,101	\$1,927,101	\$0
8.50%	Discount For Interest	(104,230)	(104,230)	0
	Present Value Contributions	1,822,871	1,822,871	0
	Prepayment Credit	1,181,774	1,181,774	0
	Present Value Of Funding	3,004,645	3,004,645	0
	CAS Funding Target	1,181,774	1,181,774	0
	Percentage Funded		100.00%	0.00%
	Funded Pension Cost		1,181,774	0
	Allowable Interest		0	0
	Allocable Pension Cost		1,181,774	0
1995	Fiscal Year Pension Cost		1,184,443	22,326
	Medicare LOB Percentage		1.82%	93.57%
	Allowable Pension Cost	<u>\$42,447</u>	<u>\$21,557</u>	<u>\$20,890</u>

**BLUE CROSS BLUE SHIELD OF ARIZONA  
STATEMENT OF ALLOWABLE PENSION COSTS  
FOR FISCAL YEARS 1991 THROUGH 2005**

Date	Description	Total Company	Other Segment	Medicare Segment
1996	Contributions	\$3,195,747	\$3,195,747	\$0
8.50%	Discount For Interest	(201,789)	(201,789)	0
	Present Value Contributions	2,993,958	2,993,958	0
	Prepayment Credit	1,672,661	1,672,661	0
	Present Value Of Funding	4,666,619	4,666,619	0
	CAS Funding Target	1,672,661	1,672,661	0
	Percentage Funded		100.00%	0.00%
	Funded Pension Cost		1,672,661	0
	Allowable Interest		0	0
	Allocable Pension Cost		1,672,661	0
1996	Fiscal Year Pension Cost		1,549,939	0
	Medicare LOB Percentage		1.52%	88.22%
	Allowable Pension Cost	<u>\$23,559</u>	<u>\$23,559</u>	<u>\$0</u>

1997	Contributions	\$346,885	\$346,885	\$0
8.50%	Discount For Interest	(27,001)	(27,001)	0
	Present Value Contributions	319,884	319,884	0
	Prepayment Credit	1,763,933	1,763,933	0
	Present Value Of Funding	2,083,817	2,083,817	0
	CAS Funding Target	1,763,933	1,763,933	0
	Percentage Funded		100.00%	0.00%
	Funded Pension Cost		1,763,933	0
	Allowable Interest		0	0
	Allocable Pension Cost		1,763,933	0
1997	Fiscal Year Pension Cost		1,741,115	0
	Medicare LOB Percentage		1.67%	88.98%
	Allowable Pension Cost	<u>\$29,077</u>	<u>\$29,077</u>	<u>\$0</u>

**BLUE CROSS BLUE SHIELD OF ARIZONA  
STATEMENT OF ALLOWABLE PENSION COSTS  
FOR FISCAL YEARS 1991 THROUGH 2005**

Date	Description	Total Company	Other Segment	Medicare Segment
1998	Contributions	\$0	\$0	\$0
9.00%	Discount For Interest	0	0	0
	Present Value Contributions	0	0	0
	Prepayment Credit	1,942,669	1,942,669	0
	Present Value Of Funding	1,942,669	1,942,669	0
	CAS Funding Target	1,942,669	1,942,669	0
	Percentage Funded		100.00%	0.00%
	Funded Pension Cost		1,942,669	0
	Allowable Interest		0	0
	Allocable Pension Cost		1,942,669	0
1998	Fiscal Year Pension Cost		1,897,985	0
	Medicare LOB Percentage		1.38%	91.99%
	Allowable Pension Cost	<u>\$26,192</u>	<u>\$26,192</u>	<u>\$0</u>

1999	Contributions	\$20,703	\$20,703	\$0
9.00%	Discount For Interest	(1,570)	(1,570)	0
	Present Value Contributions	19,133	19,133	0
	Prepayment Credit	0	0	0
	Present Value Of Funding	19,133	19,133	0
	CAS Funding Target	0	0	0
	Percentage Funded		0.00%	0.00%
	Funded Pension Cost		0	0
	Allowable Interest		0	0
	Allocable Pension Cost		0	0
1999	Fiscal Year Pension Cost		485,667	0
	Medicare LOB Percentage		1.50%	92.57%
	Allowable Pension Cost	<u>\$7,285</u>	<u>\$7,285</u>	<u>\$0</u>

**BLUE CROSS BLUE SHIELD OF ARIZONA  
STATEMENT OF ALLOWABLE PENSION COSTS  
FOR FISCAL YEARS 1991 THROUGH 2005**

Date	Description	Total Company	Other Segment	Medicare Segment
2000	Contributions	\$434,802	\$421,955	\$12,847
9.00%	Discount For Interest	(33,033)	(32,057)	(976)
	Present Value Contributions	401,769	389,898	11,871
	Prepayment Credit	1,036,433	1,005,589	30,844
	Present Value Of Funding	1,438,202	1,395,487	42,715
	CAS Funding Target	1,435,322	1,392,607	42,715
	Percentage Funded		100.00%	100.00%
	Funded Pension Cost		1,392,607	42,715
	Allowable Interest		24,672	757
	Allocable Pension Cost		1,417,279	43,472
2000	Fiscal Year Pension Cost		1,062,959	32,604
	Medicare LOB Percentage		1.85%	96.13%
	Allowable Pension Cost	<u>\$51,007</u>	<u>\$19,665</u>	<u>\$31,342</u>

2001	Contributions	\$10,374,404	\$10,241,357	\$133,047
9.00%	Discount For Interest	(778,994)	(769,004)	(9,990)
	Present Value Contributions	9,595,410	9,472,353	123,057
	Prepayment Credit	3,140	2,977	163
	Present Value Of Funding	9,598,550	9,475,330	123,220
	CAS Funding Target	2,378,013	2,254,793	123,220
	Percentage Funded		100.00%	100.00%
	Funded Pension Cost		2,254,793	123,220
	Allowable Interest		143,553	7,845
	Allocable Pension Cost		2,398,346	131,065
2001	Fiscal Year Pension Cost		2,153,079	109,167
	Medicare LOB Percentage		1.87%	97.58%
	Allowable Pension Cost	<u>\$146,788</u>	<u>\$40,263</u>	<u>\$106,525</u>

**BLUE CROSS BLUE SHIELD OF ARIZONA  
STATEMENT OF ALLOWABLE PENSION COSTS  
FOR FISCAL YEARS 1991 THROUGH 2005**

Date	Description	Total Company	Other Segment	Medicare Segment
2002	Contributions	\$15,800,000	\$15,800,000	\$0
9.00%	Discount For Interest	<u>(1,304,587)</u>	<u>(1,304,587)</u>	<u>0</u>
	Present Value Contributions	14,495,413	14,495,413	0
	Prepayment Credit	<u>3,327,360</u>	<u>3,175,277</u>	<u>152,083</u>
	Present Value Of Funding	17,822,773	17,670,690	152,083
	CAS Funding Target	3,327,360	3,175,277	152,083
	Percentage Funded		<u>100.00%</u>	<u>100.00%</u>
	Funded Pension Cost		<u>3,175,277</u>	<u>152,083</u>
	Allowable Interest		<u>0</u>	<u>0</u>
	Allocable Pension Cost		<u>3,175,277</u>	<u>152,083</u>
2002	Fiscal Year Pension Cost		2,981,044	146,829
	Medicare LOB Percentage		<u>1.65%</u>	<u>98.26%</u>
	Allowable Pension Cost	<u>\$193,461</u>	<u>\$49,187</u>	<u>\$144,274</u>

2003	Contributions	\$16,751,562	\$16,751,562	\$0
8.50%	Discount For Interest	<u>(1,311,416)</u>	<u>(1,311,416)</u>	<u>0</u>
	Present Value Contributions	15,440,146	15,440,146	0
	Prepayment Credit	<u>5,833,988</u>	<u>5,610,488</u>	<u>223,500</u>
	Present Value Of Funding	21,274,134	21,050,634	223,500
	CAS Funding Target	5,833,988	5,610,488	223,500
	Percentage Funded		<u>100.00%</u>	<u>100.00%</u>
	Funded Pension Cost		<u>5,610,488</u>	<u>223,500</u>
	Allowable Interest		<u>0</u>	<u>0</u>
	Allocable Pension Cost		<u>5,610,488</u>	<u>223,500</u>
2003	Fiscal Year Pension Cost		5,001,685	205,646
	Medicare LOB Percentage		<u>1.40%</u>	<u>98.69%</u>
	Allowable Pension Cost	<u>\$272,976</u>	<u>\$70,024</u>	<u>\$202,952</u>

**BLUE CROSS BLUE SHIELD OF ARIZONA  
STATEMENT OF ALLOWABLE PENSION COSTS  
FOR FISCAL YEARS 1991 THROUGH 2005**

Date	Description	Total Company	Other Segment	Medicare Segment
2004	Contributions	\$13,329,700	\$13,329,700	\$0
8.50%	Discount For Interest	<u>(1,044,262)</u>	<u>(1,044,262)</u>	<u>0</u>
	Present Value Contributions	12,285,438	12,285,438	0
	Prepayment Credit	<u>6,836,604</u>	<u>6,584,204</u>	<u>252,400</u>
	Present Value Of Funding	19,122,042	18,869,642	252,400
	CAS Funding Target	6,836,604	6,584,204	252,400
	Percentage Funded		<u>100.00%</u>	<u>100.00%</u>
	Funded Pension Cost		<u>6,584,204</u>	<u>252,400</u>
	Allowable Interest		<u>0</u>	<u>0</u>
	Allocable Pension Cost		<u>6,584,204</u>	<u>252,400</u>
2004	Fiscal Year Pension Cost		6,340,775	245,175
	Medicare LOB Percentage		<u>1.09%</u>	<u>98.27%</u>
	Allowable Pension Cost	<u>\$310,047</u>	<u>\$69,114</u>	<u>\$240,933</u>

2005	Contributions	\$0	\$0	\$0
8.00%	Discount For Interest	<u>0</u>	<u>0</u>	<u>0</u>
	Present Value Contributions	0	0	0
	Prepayment Credit	<u>8,226,794</u>	<u>7,931,101</u>	<u>295,693</u>
	Present Value Of Funding	8,226,794	7,931,101	295,693
	CAS Funding Target	8,226,794	7,931,101	295,693
	Percentage Funded		<u>100.00%</u>	<u>100.00%</u>
	Funded Pension Cost		<u>7,931,101</u>	<u>295,693</u>
	Allowable Interest		<u>0</u>	<u>0</u>
	Allocable Pension Cost		<u>7,931,101</u>	<u>295,693</u>
2005	Fiscal Year Pension Cost		7,594,377	284,870
	Medicare LOB Percentage		<u>0.93%</u>	<u>98.63%</u>
	Allowable Pension Cost	<u>\$351,595</u>	<u>\$70,628</u>	<u>\$280,967</u>

\* Line of business.

**BLUE CROSS BLUE SHIELD OF ARIZONA  
STATEMENT OF ALLOWABLE PENSION COSTS  
FOR FISCAL YEARS 1991 THROUGH 2005**

**FOOTNOTES**

- 1/ We obtained total company contribution amounts and dates of deposit from Internal Revenue Service Form 5500 reports. The contributions included deposits made during the plan year and accrued contributions deposited after the end of the plan year but within the time allowed for filing tax returns. The contributions allocated to the Medicare segment were determined during the pension segmentation review (A-07-06-00207). The amounts shown for the other segment represent the difference between the total company and the Medicare segment.
- 2/ We subtracted the interest that is included in the contributions deposited after January 1 of each year to discount the contributions back to their beginning of the year value. For purposes of this appendix, we computed the interest as the difference between the present value of contributions at the valuation interest rate and actual contribution amounts.
- 3/ The present value of contributions is the value of the contributions discounted from the date of deposit back to January 1. For purposes of this appendix, we deemed deposits made after the end of the plan year to have been made on the final day of the plan year consistent with the method mandated by ERISA.
- 4/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year Cost Accounting Standards (CAS) funding target. A prepayment credit may be carried forward, with interest, to fund future CAS pension costs.
- 5/ The present value of funding represents the present value of contributions plus prepayment credits. This is the amount of funding that is available to cover the CAS funding target measured at January 1 of each year.
- 6/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of the Federal Acquisition Regulations (FAR) 31.205-6(j)(2)(i).
- 7/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Since any funding in excess of the CAS funding target is considered premature funding in accordance with CAS 412.50(c)(1) (as amended), the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS funding target. For purposes of illustration, the percentage of funding has been rounded to four decimals.
- 8/ We computed the funded CAS pension cost as the CAS funding target multiplied by the percent funded.

**BLUE CROSS BLUE SHIELD OF ARIZONA  
STATEMENT OF ALLOWABLE PENSION COSTS  
FOR FISCAL YEARS 1991 THROUGH 2005**

- 9/ We assumed that interest on the funded CAS pension cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(j)(2)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target, less the prepayment credit, was funded in four equal installments deposited within 30 days of the end of the quarter.
- 10/ The allocable CAS pension cost is the amount of pension cost that may be allocated for contract cost purposes.
- 11/ We converted the plan year (January 1 through December 31) allocable pension costs to a Federal fiscal year (FY) basis (October 1 through September 30). We calculated the fiscal year pension costs as 1/4 of the prior year's costs plus 3/4 of the current year's costs. Costs charged to the Medicare contract should consist of the Medicare segment's direct pension costs plus pension costs attributable to indirect Medicare operations.
- 12/ We calculated allowable pension costs of the Medicare and other segment based on the Medicare line of business percentage of each segment. We obtained the percentages from documents provided by Arizona.
- 13/ We computed the allowable Medicare pension cost as the FY pension cost multiplied by the Medicare line of business percentage.



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Shield Association

August 17, 2006

Mr. Patrick Cogley  
Regional Inspector General for Audit Services  
Department of Health and Human Services  
Office of Inspector General  
Office of Audit Services  
Region VII  
601 East 12<sup>th</sup> Street  
Room 284A  
Kansas City, Missouri 64106

**Refer to: A-07-06-00216**

Dear Mr. Cogley:

The purpose of this letter is to submit our response to the Department of Health and Human Services Office of Inspector General's draft report on the review of Medicare pension costs claimed by Blue Cross Blue Shield of Arizona for fiscal years 1991 through 2005.

We agree with the report finding that claimed pension costs were overstated and will take the following actions to ensure the report recommendations are implemented.

- 1) Work with the Centers for Medicare and Medicaid Services to reduce claimed pension costs by \$142,343 on settlement of the Final Administrative Cost Proposals for FY's 1991 through 2005.
- 2) Work with Blue Cross Blue Shield's actuaries to ensure that the Medicare segment pension assets are developed appropriately and that pension costs are claimed in accordance with applicable cost accounting standards as well as Medicare contractual requirements.

We appreciate the opportunity to review and provide our comments prior to release of the final report. If you have any questions regarding our response, please contact Marty O'Reilly at 602-864-5393.

Sincerely

A handwritten signature in cursive script that reads "William Arthur".

William Arthur  
Director of Finance

Cc: Jay Pinkerton, CCA Strategies LLC  
Megan Seehafer, OIG/OAS  
Eric Shipley, CMS  
Hazel Johnson, CMS  
Rosalia Teran, CMS  
Mel Illagan, CMS  
Tony Astorga, BCBSAZ  
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