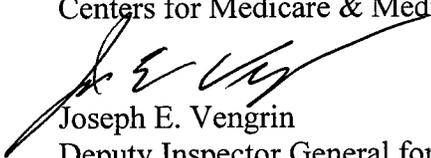




**AUG 24 2009**

**TO:** Charlene Frizzera  
Acting Administrator  
Centers for Medicare & Medicaid Services

**FROM:**   
Joseph E. Vengrin  
Deputy Inspector General for Audit Services

**SUBJECT:** Review of Medicare Segment Postretirement Benefit Assets at Noridian Administrative Services, LLC, for October 1, 2003, to January 1, 2006 (A-07-08-00280)

Attached is an advance copy of our final report on the Medicare segment postretirement benefit (PRB) assets at Noridian Administrative Services, LLC (NAS). We will issue this report to NAS within 5 business days.

NAS administered Medicare Part A and Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS). CMS reimburses a portion of its contractors' costs for PRB plans. In claiming these costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation and applicable Cost Accounting Standards, as required by the Medicare contracts.

NAS submitted a request to CMS to change its accounting practice for PRBs from the pay-as-you-go method to the segmented accrual accounting method effective October 1, 2003. CMS granted approval subject to the findings and recommendations of this review. To implement its request, NAS identified and updated Medicare segment PRB assets to January 1, 2006.

Our objective was to determine whether NAS correctly identified and updated changes in the Medicare segment's PRB assets from October 1, 2003, to January 1, 2006.

NAS correctly identified the Medicare segment's October 1, 2003, PRB assets. However, NAS did not correctly update the assets from October 1, 2003, to January 1, 2006. As part of the change in its accounting practice, NAS was required to identify and update the Medicare segment's PRB assets. However, NAS made errors in its update computations. As a result, NAS understated the Medicare segment assets as of January 1, 2006, by \$2,384,465. In addition, NAS did not make adjustments for participants who transferred into and out of the Medicare segment.

We recommend that NAS increase the Medicare segment PRB assets by \$2,384,465 as of January 1, 2006, and make adjustments for participant transfers in future updates.

In written comments, NAS disagreed with our draft report's recommendation to increase the Medicare segment PRB assets by \$2,677,457 and indicated that the assets need to be increased by \$2,384,465. NAS concurred with our recommendation to make adjustments for participant transfers in future updates.

After reviewing NAS's comments, as well as additional information provided by NAS's actuary, we revised the calculations and related recommendation in our final report to reflect the dollar amount indicated in NAS's comments.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through email at [George.Reeb@oig.hhs.gov](mailto:George.Reeb@oig.hhs.gov) or Patrick J. Cogley, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591 or through email at [Patrick.Cogley@oig.hhs.gov](mailto:Patrick.Cogley@oig.hhs.gov). Please refer to report number A-07-08-00280.

Attachment



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Offices of Audit Services

AUG 28 2009

Report Number: A-07-08-00280

Region VII  
601 East 12th Street  
Room 284A  
Kansas City, Missouri 64108

Mr. David Breuer  
Senior Vice President of Finance and Chief Financial Officer  
Noridian Mutual Insurance Company  
4510 13th Avenue South  
Fargo, North Dakota 58121-0001

Dear Mr. Breuer:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of Medicare Segment Postretirement Benefit Assets at Noridian Administrative Services, LLC, for October 1, 2003, to January 1, 2006." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this 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.

Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, OIG reports generally are made available to the public to the extent that information in the report is not subject to exemptions in the Act. Accordingly, this report will be posted on the Internet at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through email at [Jenenne.Tambke@oig.hhs.gov](mailto:Jenenne.Tambke@oig.hhs.gov). Please refer to report number A-07-08-00280 in all correspondence.

Sincerely,

Patrick J. Cogley  
Regional Inspector General  
for Audit Services

Enclosure

**Direct Reply to HHS Action Official:**

Ms. Nanette Foster Reilly  
Consortium Administrator  
Consortium for Financial Management & Fee for Service Operations  
Centers for Medicare & Medicaid Services  
601 East 12<sup>th</sup> Street, Room 235  
Kansas City, Missouri 64106

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE SEGMENT  
POSTRETIREMENT BENEFIT  
ASSETS AT NORIDIAN  
ADMINISTRATIVE SERVICES,  
LLC, FOR OCTOBER 1, 2003,  
TO JANUARY 1, 2006**



Daniel R. Levinson  
Inspector General

August 2009  
A-07-08-00280

# *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:

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# *Notices*

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Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, Office of Inspector General reports generally are made available to the public to the extent that information in the report is not subject to exemptions in the Act.

## **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**

### **BACKGROUND**

During our audit period (October 1, 2003, to January 1, 2006), Noridian Administrative Services, LLC (NAS), administered Medicare Parts A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).

Medicare 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, as required by the Medicare contracts. In addition, the Medicare contracts and the annual Budget and Performance Requirements mandate that any change in accounting practice for PRB costs be submitted to CMS for approval.

NAS submitted a request to CMS to change its accounting practice for PRBs from the pay-as-you-go method to the segmented accrual accounting method effective October 1, 2003. CMS granted approval subject to the findings and recommendations of this review. Noridian Mutual Insurance Company, the parent company of NAS, also established a voluntary employee benefit association trust to fund annual accruals. To implement its request, NAS identified and updated Medicare segment PRB assets to January 1, 2006.

### **OBJECTIVE**

Our objective was to determine whether NAS correctly identified and updated changes in the Medicare segment's PRB assets from October 1, 2003, to January 1, 2006.

### **SUMMARY OF FINDINGS**

NAS correctly identified the Medicare segment's October 1, 2003, PRB assets. However, NAS did not correctly update the assets from October 1, 2003, to January 1, 2006. As part of the change in its accounting practice, NAS was required to identify and update the Medicare segment's PRB assets. However, NAS made errors in its update computations. As a result, NAS understated the Medicare segment assets as of January 1, 2006, by \$2,384,465. In addition, NAS did not make adjustments for participants who transferred into and out of the Medicare segment.

### **RECOMMENDATIONS**

We recommend that NAS:

- increase the Medicare segment PRB assets by \$2,384,465 as of January 1, 2006, and
- make adjustments for participant transfers in future updates.

## **AUDITEE COMMENTS**

In written comments, NAS disagreed with our draft report's recommendation to increase the Medicare segment PRB assets by \$2,677,457. NAS stated that its actuary had worked with us on a revised calculation, the result of which was that “. . . Medicare segment [PRB] assets need to be increased by \$2,384,465 as of January 1, 2006.” NAS concurred with our recommendation to make adjustments for participant transfers in future updates.

NAS's comments are included in their entirety as Appendix B.

## **OFFICE OF INSPECTOR GENERAL RESPONSE**

After reviewing NAS's comments, as well as additional information provided by NAS's actuary, we revised the calculations and related recommendation in this final report to reflect the dollar amount indicated in NAS's comments.

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## INTRODUCTION

### BACKGROUND

#### **Noridian Administrative Services, LLC, and Medicare**

During our audit period (October 1, 2003, to January 1, 2006), Noridian Administrative Services, LLC (NAS), administered Medicare Parts A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).

Medicare 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), as required by the Medicare contracts.

#### **Request To Use Segmented Postretirement Benefit Accrual Accounting**

Since 1993, the "Budget and Performance Requirements" instructions sent to Medicare contractors have included a reminder of the special provisions regarding costs of PRB plans. The instructions specify that any change in accounting practice for PRB costs must be submitted to CMS in advance for approval.

NAS submitted a request to CMS to change its accounting practice for PRB costs from the pay-as-you-go method to the segmented accrual accounting method effective October 1, 2003. CMS granted approval subject to the findings and recommendations of this review. NAS, through Noridian Mutual Insurance Company (its parent company), participates in a voluntary employee benefit association (VEBA) trust for the purpose of funding annual accruals. Because NAS's request specified segmented accrual accounting for the Medicare segment, NAS identified and updated the Medicare segment's PRB assets to January 1, 2006.<sup>1</sup>

#### **Federal Regulations**

The FAR states that accrual accounting may be used to determine allowable PRB costs if the costs are measured and assigned (actuarially determined) in accordance with generally accepted accounting principles. FAR 31.205-6(o) requires that PRB accrual costs be funded in a dedicated trust fund, such as a VEBA trust. The FAR also states that allowable costs must be funded by the time set for filing the Federal income tax return or any extension thereof and must comply with the applicable standards promulgated by the CAS Board.

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<sup>1</sup>The identification is the establishment of the initial asset base. The initial asset base is updated annually by contributions, permitted unfunded accruals, income, benefit payments, and expenses.

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

### **Objective**

Our objective was to determine whether NAS correctly identified and updated changes in the Medicare segment's PRB assets from October 1, 2003, to January 1, 2006.

### **Scope**

We reviewed NAS's identification of the Medicare segment and its identification and update of Medicare PRB assets from October 1, 2003, to January 1, 2006.

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

We performed fieldwork at NAS's office in Fargo, North Dakota.

### **Methodology**

To accomplish our objective, we did the following:

- We reviewed the applicable portions of the FAR, CAS, and Medicare contracts.
- We reviewed the information provided by NAS's actuarial consulting firm, which included the VEBA 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 reviewed the PRB plan documents, Department of Labor/Internal Revenue Service Forms 5500, VEBA trust transaction documents, and PRB actuarial valuation reports. The valuation reports included Statement of Financial Accounting Standards 106 information. We used this information to calculate the Medicare segment PRB assets.
- We interviewed NAS staff responsible for determining the methodology that NAS used in its identification of the Medicare segment.
- We reviewed NAS accounting records to verify the segment identification.
- We provided the CMS Office of the Actuary with the actuarial information necessary for it to calculate the Medicare segment PRB assets as of January 1, 2006.
- We reviewed and accepted the CMS Office of the Actuary's methodology and calculations.

We performed this review in conjunction with our audit of NAS's PRB costs claimed for Medicare reimbursement (A-07-08-00281) and used the information obtained during that audit in this review. We also used information obtained in conjunction with our audit of NAS's pension segmentation (A-07-08-00258). That information included the identification of the Medicare segment and the Medicare segment participants.

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 objective.

### **FINDINGS AND RECOMMENDATIONS**

NAS correctly identified the Medicare segment's October 1, 2003, PRB assets. However, NAS did not correctly update the assets from October 1, 2003, to January 1, 2006. As part of the change in its accounting practice, NAS was required to identify and update the Medicare segment's PRB assets. However, NAS made errors in its update computations. As a result, NAS understated the Medicare segment assets as of January 1, 2006, by \$2,384,465. In addition, NAS did not make adjustments for participants who transferred into and out of the Medicare segment.

Appendix A presents details on the Medicare segment's PRB assets from October 1, 2003, to January 1, 2006, as determined during our audit. The following table summarizes the differences between our update and NAS's update of these assets.

<b>Differences in Update of Medicare Segment PRB Assets</b>			
	<b>Per Audit</b>	<b>Per NAS</b>	<b>Difference</b>
Contributions and transferred prepayment credits	\$ 7,651,777	\$ 5,551,710	\$ 2,100,067
Claims paid	(292,869)	(280,129)	(12,740)
Net investment earnings	484,203	187,065	297,138
<b>Understatement</b>			<b>\$ 2,384,465</b>

### **FEDERAL REQUIREMENTS**

The Medicare contracts do not require segmented accrual accounting for PRBs. However, because NAS stated that it would use segmented accrual accounting effective October 1, 2003, 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)." 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 based on the ratio of the segment's weighted average value of assets to the total company weighted average value of assets.

## **ERRORS IN UPDATE OF MEDICARE SEGMENT ASSETS**

In its asset update, NAS understated contributions and transferred prepayment credits by \$2,100,067, understated claims paid by \$12,740, and understated net investment earnings by \$297,138. NAS also did not adjust its asset update for participant transfers.

### **Understated Contributions and Transferred Prepayment Credits**

NAS understated contributions and transferred prepayment credits for the Medicare segment by \$2,100,067. NAS's update methodology stated that VEBA contributions would be assigned to the Medicare segment based on the segment's prior-year reimbursable costs. However, NAS did not use its stated methodology to assign VEBA contributions to the Medicare segment. Instead, NAS used segmented costs as the basis for assigning VEBA contributions to the Medicare segment. To determine the correct update of the Medicare segment's PRB assets, we followed NAS's stated methodology by using the segment's prior-year reimbursable costs as the basis for assigning contributions and prepayment credits to the Medicare segment.<sup>2</sup>

### **Understated Claims Paid**

NAS understated claims paid for the Medicare segment by \$12,740 because it misidentified some Medicare segment participants. This error resulted in an overstatement of the Medicare segment PRB assets.

### **Understated Net Investment Earnings**

NAS understated net investment earnings for the Medicare segment by \$297,138 primarily because it used incorrect amounts of contributions, transferred prepayment credits, and claims paid, as discussed above, to update the Medicare asset base. The understatement of net investment earnings led to a \$297,138 understatement of the Medicare segment assets.

### **Participant Transfers**

In its request to change its accounting practice, NAS stated that it would make adjustments for participants who transferred into and out of the Medicare segment. However, NAS's asset update did not contain such adjustments. Although we determined that this error had no material effect during our review period, future asset updates may be materially misstated if NAS does not properly adjust for transfers.

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<sup>2</sup>We addressed the development of PRB costs that were allowable for Medicare reimbursement in a related review (A-07-08-00281).

## **RECOMMENDATIONS**

We recommend that NAS:

- increase the Medicare segment PRB assets by \$2,384,465 as of January 1, 2006, and
- make adjustments for participant transfers in future updates.

## **AUDITEE COMMENTS**

In written comments,<sup>3</sup> NAS disagreed with our draft report's recommendation to increase the Medicare segment PRB assets by \$2,677,457. NAS stated that its actuary had worked with us on a revised calculation, the result of which was that ". . . Medicare segment [PRB] assets need to be increased by \$2,384,465 as of January 1, 2006." NAS concurred with our recommendation to make adjustments for participant transfers in future updates.

NAS's comments are included in their entirety as Appendix B.

## **OFFICE OF INSPECTOR GENERAL RESPONSE**

After reviewing NAS's comments, as well as additional information provided by NAS's actuary, we revised the calculations and related recommendation in this final report to reflect the dollar amount indicated in NAS's comments.

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<sup>3</sup>NAS provided a single set of written comments on both this report and a related report (A-07-08-00281).

# **APPENDIXES**

## STATEMENT OF MEDICARE POSTRETIREMENT BENEFIT ASSETS

Description	Total Company	Other Segment	Medicare Segment
Assets October 1, 2003	<u>1/</u> \$0	\$0	\$0
Transferred prepayment credits	0	0	0
Contributions	<u>2/</u> 7,100,000	6,156,363	943,637
Claims paid	<u>3/</u> 0	0	0
Investment return	<u>4/</u> 0	0	0
Assets January 1, 2004	7,100,000	6,156,363	943,637
Transferred prepayment credits	<u>5/</u> 0	(2,615,477)	2,615,477
Contributions	4,100,000	3,177,822	922,178
Claims paid	(952,335)	(796,506)	(155,829)
Investment return	474,764	241,188	233,576
Assets January 1, 2005	10,722,429	6,163,390	4,559,039
Transferred prepayment credits	0	(1,168,488)	1,168,488
Contributions	5,500,000	3,498,003	2,001,997
Claims paid	(769,187)	(632,147)	(137,040)
Investment return	497,887	247,260	250,627
Assets January 1, 2006	\$15,951,129	\$8,108,018	\$7,843,111
Per NAS	<u>6/</u> \$15,951,129	\$10,492,483	\$5,458,646
<b>Asset variance</b>	<u>7/</u> <b>\$0</b>	<b>(\$2,384,465)</b>	<b>\$2,384,465</b>

**FOOTNOTES**

1/ We obtained Total Company assets from postretirement benefits (PRB) actuarial valuation reports. The Total Company represents Noridian Mutual Insurance Company, the parent company of Noridian Administrative Services, LLC (NAS). In 2003, there were no initial assets assigned to the Medicare segment. The amounts shown for the "Other" segment represent the difference between the Total Company and NAS, the Medicare segment. All PRB assets are shown at market value.

- 2/ We obtained Total Company contribution amounts from PRB actuarial valuation reports and trust statements. We allocated Total Company contributions to the Medicare segment based on the ratio of the Medicare segment current-period funding requirement divided by the Total Company current-period funding requirement after the application of any accumulated prepayment credits. Contributions in excess of the current-period funding requirement 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.
- 3/ Claims paid represent benefits paid directly from the trust fund. We obtained Medicare segment claims paid amounts from documents prepared by NAS’s actuarial consulting firm.
- 4/ We obtained investment earnings from the PRB actuarial valuation reports and documents prepared by NAS’s actuarial consulting firm. We allocated net investment earnings based on the ratio of the segment’s weighted average value (WAV) of assets to Total Company WAV of assets.
- 5/ A prepayment credit represents the accumulated value of premature funding from the previous year(s) and is available as of the first day of the plan year to cover, or help cover, the cost assigned to that period. Prepayment credits are accounted for as a part of the “Other” segment assets and are transferred to the Medicare segment as of the first day of each plan year to cover the cost assigned to that year.
- 6/ We obtained asset amounts as of January 1, 2006, from documents prepared by NAS’s actuarial consulting firm.
- 7/ The asset variance represents the difference between our calculation of Medicare segment assets and NAS’s Medicare segment assets.



May 13, 2009

Mr. Patrick J. Cogley  
Regional Inspector General for Audit Services  
Department of Health & Human Services  
601 East 12<sup>th</sup> Street  
Room 0429  
Kansas City, MO 64106

RE: Report Number A-07-08-00280 and A-07-08-00281

Dear Mr. Cogley:

We have reviewed your draft reports entitled "Review of Medicare Segment Postretirement Benefit Assets at Noridian Administrative Services, LLC for October 1, 2003, to January 1, 2006" and "Review of Postretirement Benefit Costs Claimed for Medicare Reimbursement by Noridian Administrative Services, LLC, for Fiscal Years 2004 and 2005" and offer the following comments:

Recommendations - "Review of Medicare Segment Postretirement Benefit Assets"

- **Increase Medicare segment assets by \$2,677,457 as of January 1, 2006**
  - After reviewing the calculations in the draft report, our actuary, Patrick Ward with JP Morgan Compensation and Benefit Strategies, worked with the OIG on a revised calculation, which was agreed upon between both parties. Based on those calculations, Medicare segment assets need to be increased by \$2,384,465 as of January 1, 2006.
- **Make adjustments for participant transfers in future updates.**
  - We concur with this recommendation and will ensure that participant transfers are monitored and updated.

Page 2

Recommendations – “Review of Postretirement Benefit Costs Claimed”

- **Revise the Final Administrative Cost Proposals to refund to the Federal Government unallowable accrued PRB costs of \$3,831 for FYs 2004 and 2005 and claim future PRB costs in accordance with the Medicare contract.**
  - After reviewing the calculations in the draft report, our actuary worked with the OIG on a revised calculation, which was agreed upon between both parties. Based on those calculations, we will need to refund to the Federal Government unallowable PRB costs of \$315,913 for FYs 2004 and 2005.

Sincerely,



David Breuer  
Senior Vice President of Finance and CFO