



May 5, 2010

Report Number: A-07-09-00308

Mr. Ron Simmons
Controller
Blue Cross Blue Shield of Kansas
1133 SW Topeka Boulevard
Topeka, KS 66612

Dear Mr. Simmons:

Enclosed is the U.S. Department of Health & Human Services (HHS), Office of Inspector General (OIG), final report entitled *Review of the Qualified Pension Plan at Blue Cross Blue Shield of Kansas, a Terminated Medicare Contractor, for the Period January 1, 1993, to February 29, 2008*. 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.

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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, or contact 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-07-09-00308 in all correspondence.

Sincerely,

/Patrick J. Cogley/
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

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Acting Director & Chief Financial Officer
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Department of Health & Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF THE QUALIFIED
PENSION PLAN AT BLUE CROSS
BLUE SHIELD OF KANSAS,
A TERMINATED MEDICARE
CONTRACTOR, FOR THE PERIOD
JANUARY 1, 1993, TO
FEBRUARY 29, 2008**



Daniel R. Levinson
Inspector General

May 2010
A-07-09-00308

Office of Inspector General

<http://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

BACKGROUND

Blue Cross Blue Shield of Kansas (Kansas) administered Medicare Part A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until the contractual relationship was terminated effective February 29, 2008. The closing date for the Medicare segment was February 29, 2008.

Since its inception, Medicare has paid a portion of contractors' contributions to their pension plans. These contributions are allowable Medicare costs subject to the criteria set forth in the Federal Acquisition Regulation, Cost Accounting Standards (CAS), and Medicare contracts. Furthermore, in situations such as contract terminations, the Medicare contracts require contractors to identify excess Medicare segment pension assets/liabilities in accordance with CAS 413.

Pension Segmentation

Beginning with fiscal year 1988, CMS incorporated segmentation requirements into the Medicare contracts. The Medicare contracts define a segment and specify the methodology for the identification and initial allocation of pension assets to the segment. Accordingly, the contracts require Medicare segment assets to be updated for each year after the initial allocation in accordance with CAS 412 and 413.

Upon the termination of its Medicare contracts, Kansas identified Medicare's share of the Medicare segment excess pension liabilities to be \$2,706,283.

We performed a prior pension segmentation audit at Kansas (A-07-94-00804, issued March 9, 1995) which brought the Medicare segment pension assets to January 1, 1993. We recommended that Kansas decrease its Medicare segment pension assets by \$142,715, and as a result, recognize \$4,531,516, as the Medicare segment pension assets as of January 1, 1993.

OBJECTIVE

Our objective was to determine whether Kansas complied with Federal requirements and the Medicare contracts' pension segmentation requirements when:

- implementing the prior audit recommendation,
- updating the Medicare segment's pension assets from January 1, 1993, to February 29, 2008, and
- determining Medicare's share of the Medicare segment excess pension liabilities as a result of the termination of the Medicare contracts.

SUMMARY OF FINDINGS

Kansas did not implement the prior audit recommendation and did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements when updating Medicare segment assets to February 29, 2008. Kansas identified Medicare segment pension assets of \$9,085,222; however, we determined that the Medicare segment pension assets were \$9,467,977 as of February 29, 2008. Furthermore, Kansas did not correctly account for the 2007 contributions made to the pension plan when updating its total company pension assets from January 1, 2007, through December 31, 2007. As a result of the errors, Kansas understated the Medicare segment pension assets by \$382,755, and the total company pension assets by \$15,000,000, as of February 29, 2008.

In addition, Kansas did not fully comply with Federal requirements in its calculation of Medicare's share of the Medicare segment excess pension liabilities associated with the termination of the Medicare contracts. Kansas computed Medicare's share of the Medicare segment excess pension liabilities to be \$2,706,283; however, we determined that Medicare's share of the Medicare segment excess pension liabilities was \$1,864,238 as of February 29, 2008. Accordingly, we determined that Kansas overstated Medicare's share of excess pension liabilities, due to the termination of the Medicare contracts, by \$842,045.

RECOMMENDATIONS

We recommend that Kansas:

- increase Medicare segment pension assets as of February 29, 2008, by \$382,755 and recognize \$9,467,977 as the Medicare segment pension assets;
- increase its total company pension assets as of February 29, 2008, by \$15,000,000 and recognize \$183,793,500 as the total company pension assets; and
- decrease Medicare's share of the Medicare segment excess pension liabilities by \$842,045 and submit for reimbursement \$1,864,238 as Medicare's share of the excess pension liabilities due to the segment closing calculation.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, Kansas concurred with the first and second recommendations; however, it disagreed with our third recommendation. Kansas disagreed with our calculations to identify the Medicare segment excess pension liabilities, Medicare's share of the Medicare segment excess pension liabilities, and our use of February 29, 2008, as the segment closing date. Kansas's comments are included in their entirety as Appendix D.

After reviewing Kansas's comments, we made minor revisions to the calculation of the Medicare segment excess pension liabilities and the Medicare segment pension assets; however, we disagreed with Kansas's comments regarding both the calculation of the Medicare's share of the excess Medicare segment pension liabilities and the segment closing date. Accordingly, we maintain that our findings and recommendations, as modified, are valid.

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- D: AUDITEE COMMENTS

Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
FAR	Federal Acquisition Regulation
Kansas	Blue Cross Blue Shield of Kansas
WAV	weighted average value

INTRODUCTION

BACKGROUND

Blue Cross Blue Shield of Kansas and Medicare

Blue Cross Blue Shield of Kansas (Kansas) administered Medicare Part A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until the contractual relationship was terminated effective February 29, 2008. The closing date for the Medicare segment was February 29, 2008.

Since its inception, Medicare has paid a portion of contractors' contributions to their pension plans. These contributions are allowable Medicare costs subject to the criteria set forth in the Federal Acquisition Regulation (FAR), Cost Accounting Standards (CAS), and Medicare contracts. Furthermore, in situations such as contract terminations, the Medicare contracts require contractors to identify excess Medicare segment pension assets/liabilities in accordance with CAS 413.

Federal Requirements

CAS 412 addresses the determination and measurement of pension cost components. It also addresses the assignment of pension costs to appropriate accounting periods.

CAS 413 addresses 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. CAS 413 also addresses the determination of segment assets and liabilities in the event of contract terminations, segment closings, or pension plan terminations.

Pension Segmentation

Beginning with fiscal year 1988, CMS incorporated segmentation requirements into the Medicare contracts. The Medicare contracts define a segment and specify the methodology for the identification and initial allocation of pension assets to the segment. Additionally, the contracts require Medicare segment assets to be updated for each year after the initial allocation in accordance with CAS 412 and 413. In claiming costs, contractors must follow cost reimbursement principles contained in the FAR, CAS, and the Medicare contracts.

Upon the termination of its Medicare contracts, Kansas identified Medicare's share of the Medicare segment excess pension liabilities to be \$2,706,283.

Prior Pension Segmentation Audit Report

We performed a prior pension segmentation audit at Kansas (A-07-94-00804, issued March 9, 1995) which brought the Medicare segment pension assets to January 1, 1993. The

prior audit found that Kansas overstated the Medicare segment pension assets by \$142,715 as of January 1, 1993. We recommended that Kansas decrease its Medicare segment pension assets by \$142,715, and as a result, recognize \$4,531,516, as the Medicare segment pension assets as of January 1, 1993.

OBJECTIVE, SCOPE AND METHODOLOGY

Objective

Our objective was to determine whether Kansas complied with Federal requirements and the Medicare contracts' pension segmentation requirements when:

- implementing the prior audit recommendation,
- updating the Medicare segment's pension assets from January 1, 1993, to February 29, 2008, and
- determining Medicare's share of the Medicare segment excess pension liabilities as a result of the termination of the Medicare contracts.

Scope

We reviewed Kansas's identification of its Medicare segment; update of Medicare segment assets from January 1, 1993, to February 29, 2008; and the segment closing calculation as of February 29, 2008.

Achieving our objective did not require us to review Kansas's overall internal control structure. We reviewed controls relating to the identification of the Medicare segment, the update of the segment's assets, and the segment closing calculation to ensure adherence to the Medicare contracts, CAS 412, and CAS 413.

We performed fieldwork at Kansas's office in Topeka, Kansas, during February 2009.

Methodology

To accomplish our objective, we did the following:

- We reviewed the applicable portions of the FAR, CAS, and the Medicare contracts.
- We reviewed the annual actuarial valuation reports prepared by Kansas's actuarial consulting firms, which included the pension plan's assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We used this information to calculate the Medicare segment assets.
- We reviewed the Medicare segment closing calculation prepared by Kansas's actuarial consulting firms.

- We obtained and reviewed the pension plan documents and Department of Labor/Internal Revenue Service (IRS) Forms 5500 used in calculating the Medicare segment assets.
- We interviewed Kansas staff responsible for identifying the Medicare segment to determine whether the segment was properly identified in accordance with the Medicare contracts.
- We reviewed Kansas's accounting records to verify the segment identification and benefit payments made to the Medicare segment.
- We reviewed the prior segmentation audit performed at Kansas (A-07-94-00804) 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 both the Medicare segment pension assets from January 1, 1993, to February 29, 2008, and the Medicare segment's excess pension liabilities as of February 29, 2008.
- We reviewed the CMS actuaries' methodology and calculations.

We performed this review in conjunction with our audit of Kansas's pension costs claimed for Medicare reimbursement (A-07-09-00309) and used the information obtained during that audit in this review.

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

Kansas did not implement the prior audit recommendation and did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements when updating Medicare segment assets to February 29, 2008. Kansas identified Medicare segment pension assets of \$9,085,222; however, we determined that the Medicare segment pension assets were \$9,467,977 as of February 29, 2008. Furthermore, Kansas did not correctly account for a 2007 contribution made to the pension plan when updating its total company pension assets from January 1, 2007, through December 31, 2007. As a result of the errors, Kansas understated the Medicare segment pension assets by \$382,755, and the total company pension assets by \$15,000,000, as of February 29, 2008.

Appendix A presents details on the Medicare segment's pension assets from January 1, 1993, to February 29, 2008, as determined during our audit. Table 1 summarizes the audit adjustment required to update Medicare segment pension assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments			
	Per OIG	Per Kansas	Difference
Prior Audit Recommendation	\$4,531,516	\$4,673,617	(\$142,101)
Update of Medicare Segment Assets			
Contributions and Prepayment Credits	11,546,820	11,475,942	\$70,878
Benefit Payments	16,775,967	18,263,949	\$1,487,982
Transfers	(4,109,276)	(3,105,119)	(\$1,004,157)
Earnings Net Expenses	8,838,411	8,868,258	(\$29,847)
Under/(Over)statement of Medicare Pension Segment Assets			\$382,755

In addition, CAS 413 requires a segment closing adjustment to be made in order to recognize Medicare's share of the Medicare segment excess pension liabilities as a result of the termination of the Medicare contracts. Kansas did not fully comply with Federal requirements in its calculation of Medicare's share of the Medicare segment excess pension liabilities associated with the termination of the Medicare contracts. Kansas computed Medicare's share of the Medicare segment excess pension liabilities to be \$2,706,283; however, we determined that Medicare's share of the Medicare segment excess pension liabilities was \$1,864,238 as of February 29, 2008. Accordingly, we determined that Kansas overstated Medicare's share of excess pension liabilities, due to the termination of the Medicare contracts, by \$842,045.

PRIOR AUDIT RECOMMENDATION

Kansas did not implement the prior audit recommendation (A-07-94-00804) which recommended that Kansas decrease Medicare segment pension assets by \$142,715, and recognize \$4,531,516 of Medicare segment pension assets as of January 1, 1993. Therefore, the Medicare segment pension assets were overstated by \$142,715 as of January 1, 1993. We used \$4,531,516 as the beginning market value of assets for the current audit.

UPDATE OF MEDICARE SEGMENT PENSION ASSETS

Kansas did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements when updating Medicare segment assets to February 29, 2008.

Federal Requirements

The Medicare contracts identify a Medicare segment as:

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

1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or,
2. Less than a majority of the salary dollars 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 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 adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses. The CAS requires expenses to be allocated among the segments in proportion to the investment earnings. 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.

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 (WAV) of assets to total company WAV of assets.

Furthermore, 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.

Contributions and Prepayment Credits Understated

Kansas understated contributions and prepayment credits by \$70,878 for the Medicare segment. This understatement occurred because of differences in the Medicare segment assets. These differences created an incorrect allocation of funding to the Medicare segment. As a result, Kansas understated contributions and prepayment credits for the Medicare segment by \$70,878.

The audited contributions and prepayment credits are based on the assignable pension costs. In compliance with the CAS, we applied prepayment credits first to current-year assignable pension costs because the credits were available at the beginning of the year, and then updated any remaining credits with interest to the next measurement (valuation) date. We then allocated contributions as needed to assigned pension costs as of the date of deposit.

Benefit Payments Overstated

Kansas overstated benefit payments by \$1,487,982 primarily because it incorrectly included a non-Medicare segment participant's benefit payment in 2004. Therefore, the Medicare segment assets were understated by \$1,487,982.

Net Transfers Understated

Kansas understated transfers out of the Medicare segment by \$1,004,157. The understatement occurred primarily because of differences in the Medicare segment participants. This understatement of the net transfer adjustment resulted in an overstatement of the Medicare segment assets by \$1,004,157.

A comparison of Kansas's and our calculations of net asset transfers from the Medicare segment appears in Table 2.

	OIG	Kansas	Difference
1993	76,304	(\$54,665)	(\$130,969)
1994	(369,422)	39,888	409,310
1995	(320,553)	(252,040)	68,513
1996	(467,999)	(642,825)	(174,826)
1997	(568,128)	(368,540)	199,588
1998	(25,225)	(290,978)	(265,753)
1999	(446,024)	(441,618)	4,406
2000	(151,493)	12,012	163,505
2001	745,400	(2,448)	(747,848)
2002	214,469	(122,140)	(336,609)
2003	(1,123,122)	721,058	1,844,180
2004	(13,882)	(9,417)	4,465
2005	(72,611)	(537,519)	(464,908)
2006	(539,360)	(66,184)	473,176
2007	(1,047,630)	(1,089,703)	(42,073)
Total	(4,109,276)	(\$3,105,119)	\$1,004,157

Earnings Net Expenses Overstated

Kansas overstated investment earnings, less administrative expenses, by \$29,847 for the Medicare segment because it (a) did not implement the prior audit recommendation to adjust the beginning market value of assets as of January 1, 1993, and (b) used incorrect contribution and prepayment credit amounts, benefit payment amounts, and transfer amounts (all discussed above) to develop the Medicare segment pension asset base. In our audited update, we allocated earnings and expenses based on the applicable CAS requirements.

TOTAL COMPANY PENSION ASSETS AS OF FEBRUARY 29, 2008

Federal Requirements

CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, unfunded accruals, income, benefit payments, and expenses.

Total Company Pension Assets Understated

Kansas understated total company pension assets by \$15,000,000 because it did not account for a 2007 contribution made to the pension plan when updating its total company pension assets. We included the contribution in our update of the total company pension assets and determined that Kansas understated the total company pension assets as of February 29, 2008, by \$15,000,000.

MEDICARE SEGMENT EXCESS PENSION LIABILITIES

Federal Requirements

Medicare Contracts

In the event of a contract termination, the Medicare contracts require contractors to follow the segment closing provision of the CAS. Furthermore, in situations such as contract terminations, the Medicare contracts require contractors to identify excess Medicare pension liabilities in accordance with CAS 413.

Cost Accounting Standards

Contract terminations and segment closings are addressed by CAS 413.50(c)(12), which states:

If a segment is closed, if there is a pension plan termination, or if there is a curtailment of benefits, the contractor shall determine the difference between the actuarial liability for the segment and the market value of the assets allocated to the segment, irrespective of whether or not the pension plan is terminated. The difference between the market value of the assets and the actuarial accrued liability for the segment represents an adjustment of previously-determined pension costs.

- (i) The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs....
- (ii) ... The market value of the assets shall be reduced by the accumulated value of prepayment credits, if any. Conversely, the market value of assets shall be increased by the current value of any unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2).
- (iii) The calculation of the difference between the market value of the assets and the actuarial accrued liability shall be made as of the date of the event (e.g., contract termination, plan amendment, plant closure) that caused the closing of the segment, pension plan termination, or curtailment of benefits. If such a date is not readily determinable, or if its use can result in an inequitable calculation, the contracting parties shall agree on an appropriate date.

(iv) Pension plan improvements adopted within 60 months of the date of the event which increase the actuarial accrued liability shall be recognized on a prorata basis using the number of months the date of adoption preceded the event date. Plan improvements mandated by law or collective bargaining agreement are not subject to this phase-in.

Excess Medicare Segment Pension Liabilities as of February 29, 2008

Kansas identified \$2,706,283 in excess Medicare segment pension liabilities as of February 29, 2008. However, we calculated the excess Medicare segment pension liabilities to be \$1,903,255 as of that date. Therefore, Kansas overstated the excess pension liabilities by \$803,028. The overstatement occurred because Kansas did not fully comply with Federal requirements in its calculation of the Medicare segment's excess pension liabilities. Specifically, Kansas overstated the Medicare segment excess pension liabilities because (a) it understated the Medicare segment's final market value of assets (as previously discussed), (b) it did not adjust the Medicare segment's final market value of assets by the unfunded actuarial liabilities, and (c) it did not adjust the final accrued actuarial liabilities by the prorated 2006 plan amendment. Appendix B shows a comparison of our and Kansas's calculations of the excess Medicare segment pension liabilities as of February 29, 2008. The development of the excess Medicare segment pension liabilities was used to determine Medicare's share of the Medicare segment excess pension liabilities below.

Medicare's Share of Excess Pension Liabilities as of February 29, 2008

Federal Requirements

The methodology for determining the Federal Government's share of excess pension liabilities is addressed by CAS 413.50(c)(12)(vi), which states:

The Government's share of the adjustment amount determined for a segment shall be the product of the adjustment amount and a fraction. The adjustment amount shall be reduced for any excise tax imposed upon assets withdrawn from the funding agency of a qualified pension plan. The numerator of such fraction shall be the **sum of the pension plan costs** allocated to all contracts and subcontracts (including Foreign Military Sales) subject to this Standard during a period of years representative of the Government's participation in the pension plan. The denominator of such fraction shall be the **total pension costs** assigned to cost accounting periods during those same years. This amount shall represent an adjustment of contract prices or cost allowance as appropriate. The adjustment may be recognized by modifying a single contract, several but not all contracts, or all contracts, or by use of any other suitable technique. [Emphasis added.]

Medicare's Share of the Excess Medicare Segment Pension Liabilities Overstated

Kansas did not comply with the Medicare contracts in determining Medicare's share of the excess pension liabilities associated with the termination of the Medicare contracts as of

February 29, 2008. Kansas calculated \$2,706,283 as Medicare’s share of the Medicare segment excess pension liabilities as of February 29, 2008; however, we determined that Medicare’s share of the Medicare segment excess pension liabilities was \$1,864,238. The overstatement occurred because Kansas (a) overstated the Medicare segment’s excess pension liabilities (as discussed above) and (b) did not compute the aggregate Medicare percentage in accordance with the CAS. Therefore, Kansas overstated Medicare’s share of the Medicare segment excess pension liabilities by \$842,045.

In accordance with CAS 413.50(c)(12)(vi), we calculated the aggregate Medicare percentage using the Medicare segment pension costs developed during the prior pension cost claimed (A-07-94-01105) and current pension cost claimed (A-07-09-00309) audits. Appendix C shows our calculation of the Medicare segment’s aggregate Medicare percentage; Table 3 shows our calculation of Medicare’s share of the excess liabilities.

Table: 3 Calculation of Medicare's Share of the Excess Medicare Segment Pension Liabilities			
	<u>Excess Medicare Segment Liabilities</u> (A)	<u>Aggregate Medicare Percentage</u> (B)	<u>Excess Liabilities Attributable to Medicare</u> (A x B)
Per OIG	\$1,903,255	97.95%	\$1,864,238
Per Kansas	2,706,283	100.00%	2,706,283
Difference			(\$842,045)

RECOMMENDATIONS

We recommend that Kansas:

- increase Medicare segment pension assets as of February 29, 2008, by \$382,755 and recognize \$9,467,977 as the Medicare segment pension assets;
- increase its total company pension assets as of February 29, 2008, by \$15,000,000 and recognize \$183,793,500 as the total company pension assets; and
- decrease Medicare’s share of the Medicare segment excess pension liabilities by \$842,045 and submit for reimbursement \$1,864,238 as Medicare’s share of the excess pension liabilities due to the segment closing calculation.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, Kansas concurred with the first and second recommendations; however, it disagreed with our third recommendation. A summary of Kansas’s comments and our response follows. Kansas’s comments are included in their entirety as Appendix D.

After reviewing Kansas's comments, we made minor revisions to the calculation of the Medicare segment excess pension liabilities and the Medicare segment pension assets; however, we disagreed with Kansas's comments regarding both the calculation of the Medicare's share of the excess Medicare segment pension liabilities and the segment closing date. Accordingly, we maintain that our findings and recommendations, as modified, are valid.

Excess Medicare Segment Pension Liabilities

Auditee Comments

Kansas stated that the Medicare segment's excess pension liabilities should be reduced by \$41,404 to \$802,541. Specifically, Kansas stated that the Employee Retirement Income Security Act Funding Standard Account plan amendment included both the IRS limits and the pre-retirement death benefit amendment; however, only the pre-retirement death benefit amendment should, according to Kansas, have been measured. Kansas also said that using the ratio of the Medicare segment accrued liabilities to the total company accrued liabilities would be a better ratio to allocate the plan amendment to the Medicare segment. As part of its written comments, Kansas provided the actual amount of the plan amendment associated with the pre-retirement death benefit only.

Office of Inspector General Response

We agree that only the pre-retirement death benefit was required to be prorated for the segment closing calculation; however, during the course of the audit, the best available information for this plan amendment was in the valuation report, which combined the IRS compensation limit increases and the pre-retirement death benefit amendment.

As part of its written comments, Kansas provided the actual amount of the plan amendment associated with the Medicare segment for the pre-retirement death benefit. We accepted this figure and revised our calculations to incorporate the new plan amendment amount for the Medicare segment. Furthermore, during our review of Kansas's comments, we identified a discrepancy in the Medicare segment pension assets. We have revised the dollar amounts in the relevant findings and in our first and third recommendations to reflect both the information provided by Kansas that we accepted and our correction of the discrepancy in the Medicare segment pension assets.

Calculation of Medicare's Share of the Medicare Segment Excess Pension Liabilities

Auditee Comments

Kansas stated that the difference between Kansas's and our calculation of Medicare's share of the excess liabilities should be \$843,945 (which, after application of the revisions discussed just above, equates to \$803,028) as shown in Appendix B not \$882,123 (which, after application of the revisions discussed just above, equates to \$842,045). Kansas said that the more accurate calculation of the difference between Kansas's and our calculation of Medicare's share of the

excess liabilities would be \$802,541, a dollar amount which reflects Kansas's calculation of Medicare's share of the Medicare segment excess pension liabilities as 100 percent.

Office of Inspector General Response

We disagree with Kansas that \$802,541 (which, after application of the revisions discussed just above, equates to \$803,028) is the difference in between Kansas's and our calculation of Medicare's share of the Medicare segment excess pension liabilities. Although Kansas computed Medicare's share of the Medicare segment excess pension liabilities as 100 percent, we determined that Medicare share's of the Medicare segment excess pension liabilities was only 97.95 percent. Accordingly, we calculated that Medicare's share of the Medicare segment excess pension liabilities was \$1,864,238, a difference of \$842,045 from Kansas's calculation. We calculated Medicare's share of the Medicare segment excess pension liabilities in accordance with the CAS. Therefore, we maintain that our finding and recommendation, as modified in accordance with our earlier discussion, are valid.

Segment Closing Date

Auditee Comments

Kansas said that it believes that using a date of February 29, 2008, to perform the segment closing adjustment resulted in an inequitable calculation of Medicare's share of excess pension liabilities. Kansas stated that CAS section 413-50(c)(12)(iii) provides that if the use of the contract termination date results in an "inequitable calculation, the contracting parties shall agree on an appropriate date."

Office of Inspector General Response

We disagree with Kansas's assertion that the use of February 29, 2008, as the contract closing date is not in compliance with the CAS because it results in an inequitable calculation. Kansas's Medicare contract was terminated and operations ended as of February 29, 2008. Kansas's assertion that CAS 413.50(c)(12)(iii) requires the Government to recognize factors beyond the accounting period in which the Medicare operations ceased is therefore incorrect. The purpose of the segment closing adjustment is to ensure that the Government contributed its fair share to the pension plan, not to compensate for future fluctuations in the market. Furthermore, Kansas prepared and provided us with its segment closing calculation as of February 29, 2008—the same contract closing date we used. Therefore, nothing in Kansas's written comments caused us to change our finding and recommendation with respect to the segment closing date.

APPENDIXES

**APPENDIX A: STATEMENT OF MARKET VALUE OF PENSION ASSETS
FOR BLUE CROSS BLUE SHIELD OF KANSAS
FOR THE PERIOD JANUARY 1, 1993, TO FEBRUARY 29, 2008**

Description		Total Company	"Other" Segment	Medicare Segment
Assets January 1, 1993	<u>1/</u>	\$32,151,373	\$27,619,857	\$4,531,516
Prepayment Credits		0	0	0
Contributions	<u>2/</u>	2,763,827	2,102,443	661,384
Earnings	<u>3/</u>	3,257,552	2,798,422	459,130
Benefit Payments	<u>4/</u>	(1,548,815)	(1,448,697)	(100,118)
Expenses	<u>5/</u>	(227,801)	(195,694)	(32,107)
Transfers	<u>6/</u>	0	(76,304)	76,304
Assets January 1, 1994		\$36,396,136	\$30,800,027	\$5,596,109
Prepayment Credits	<u>7/</u>	0	0	0
Contributions		3,301,750	3,301,750	0
Earnings		218,598	184,987	33,611
Benefit Payments		(2,931,258)	(2,843,427)	(87,831)
Expenses		(182,303)	(154,273)	(28,030)
Transfers		0	369,422	(369,422)
Assets January 1, 1995		\$36,802,923	\$31,658,486	\$5,144,437
Prepayment Credits		0	(321,953)	321,953
Contributions		4,841,435	4,841,435	0
Earnings		9,858,280	8,480,256	1,378,024
Benefit Payments		(1,201,140)	(1,151,314)	(49,826)
Expenses		(177,009)	(152,266)	(24,743)
Transfers		0	320,553	(320,553)
Assets January 1, 1996		\$50,124,489	\$43,675,197	\$6,449,292
Prepayment Credits		0	(515,824)	515,824
Contributions		3,439,843	3,439,843	0
Earnings		7,679,273	6,694,226	985,047
Benefit Payments		(3,277,343)	(1,819,446)	(1,457,897)
Expenses		(238,174)	(207,623)	(30,551)
Transfers		0	467,999	(467,999)
Assets January 1, 1997		\$57,728,088	\$51,734,372	\$5,993,716
Prepayment Credits		0	(406,441)	406,441
Contributions		950,670	950,670	0
Earnings		11,607,644	10,317,477	1,290,167
Benefit Payments		(2,987,833)	(2,727,463)	(260,370)
Expenses		(271,025)	(240,901)	(30,124)
Transfers		0	568,128	(568,128)
Assets January 1, 1998		\$67,027,544	\$60,195,842	\$6,831,702

Description	Total Company	"Other" Segment	Medicare Segment
Assets January 1, 1998	\$67,027,544	\$60,195,842	\$6,831,702
Prepayment Credits	0	0	0
Contributions	0	0	0
Earnings	10,415,267	9,341,570	1,073,697
Benefit Payments	(4,967,279)	(4,611,379)	(355,900)
Expenses	(366,948)	(329,120)	(37,828)
Transfers	0	25,225	(25,225)
Assets January 1, 1999	\$72,108,584	\$64,622,138	\$7,486,446
Prepayment Credits	0	(44,898)	44,898
Contributions	738,484	716,571	21,913
Earnings	11,772,892	10,543,129	1,229,763
Benefit Payments	(3,537,987)	(3,172,122)	(365,865)
Expenses	(327,922)	(293,668)	(34,254)
Transfers	0	446,024	(446,024)
Assets January 1, 2000	\$80,754,051	\$72,817,174	\$7,936,877
Prepayment Credits	0	(992)	992
Contributions	141,267	17,235	124,032
Earnings	(3,315,274)	(2,987,986)	(327,288)
Benefit Payments	(3,009,780)	(2,761,784)	(247,996)
Expenses	(455,172)	(410,237)	(44,935)
Transfers	0	151,493	(151,493)
Assets January 1, 2001	\$74,115,092	\$66,824,903	\$7,290,189
Prepayment Credits	0	(10)	10
Contributions	20,157,250	19,606,270	550,980
Earnings	(3,904,612)	(3,524,579)	(380,033)
Benefit Payments	(4,056,753)	(3,747,383)	(309,370)
Expenses	(378,777)	(341,911)	(36,866)
Transfers	0	(745,400)	745,400
Assets January 1, 2002	\$85,932,200	\$78,071,890	\$7,860,310
Prepayment Credits	0	(684,598)	684,598
Contributions	31,500,000	31,500,000	0
Earnings	(6,740,425)	(6,131,721)	(608,704)
Benefit Payments	(9,881,347)	(7,419,656)	(2,461,691)
Expenses	(312,612)	(284,381)	(28,231)
Transfers	0	(214,469)	214,469
Assets January 1, 2003	\$100,497,816	\$94,837,065	\$5,660,751

Description	Total Company	"Other" Segment	Medicare Segment
Assets January 1, 2003	\$100,497,816	\$94,837,065	\$5,660,751
Prepayment Credits	0	(1,312,053)	1,312,053
Contributions	35,100,000	35,100,000	0
Earnings	16,953,640	15,780,052	1,173,588
Benefit Payments	(11,259,790)	(10,448,330)	(811,460)
Expenses	(403,512)	(375,580)	(27,932)
Transfers	0	1,123,122	(1,123,122)
Assets January 1, 2004	\$140,888,154	\$134,704,276	\$6,183,878
Prepayment Credits	0	(1,282,902)	1,282,902
Contributions	16,000,000	16,000,000	0
Earnings	13,626,625	12,897,811	728,814
Benefit Payments	(8,384,466)	(8,073,152)	(311,314)
Expenses	(566,053)	(535,778)	(30,275)
Transfers	0	13,882	(13,882)
Assets January 1, 2005	\$161,564,260	\$153,724,137	\$7,840,123
Prepayment Credits	0	(1,570,264)	1,570,264
Contributions	13,000,000	13,000,000	0
Earnings	11,963,123	11,298,832	664,291
Benefit Payments	(11,984,506)	(10,441,014)	(1,543,492)
Expenses	(575,412)	(543,460)	(31,952)
Transfers	0	72,611	(72,611)
Assets January 1, 2006	\$173,967,465	\$165,540,842	\$8,426,623
Prepayment Credits	0	(1,839,353)	1,839,353
Contributions	7,000,000	7,000,000	0
Earnings	20,712,350	19,467,287	1,245,063
Benefit Payments	(15,250,563)	(14,716,973)	(533,590)
Expenses	(600,989)	(564,862)	(36,127)
Transfers	0	539,360	(539,360)
Assets January 1, 2007	\$185,828,263	\$175,426,301	\$10,401,962
Prepayment Credits	0	(1,917,123)	1,917,123
Contributions	15,000,000	15,000,000	0
Earnings	13,693,734	12,830,767	862,967
Benefit Payments	(19,455,678)	(17,012,904)	(2,442,774)
Expenses	(756,277)	(708,617)	(47,660)
Transfers	0	1,047,630	(1,047,630)
Assets January 1, 2008	\$194,310,042	\$184,666,054	\$9,643,988

Description		Total Company	"Other" Segment	Medicare Segment
Assets January 1, 2008		\$194,310,042	\$184,666,054	\$9,643,988
Prepayment Credits		0	(292,100)	292,100
Contributions		0	0	0
Earnings		(9,023,211)	(8,560,145)	(463,066)
Benefit Payments		(1,395,024)	(1,395,024)	0
Expenses		(98,307)	(93,262)	(5,045)
Transfers		0	0	0
Assets February 29, 2008		\$183,793,500	\$174,325,523	\$9,467,977
Per Kansas	8/	\$168,793,500	\$159,708,278	\$9,085,222
Asset Variance	9/	\$15,000,000	(\$14,617,245)	(\$382,755)

FOOTNOTES

- 1/ We determined the Medicare segment pension assets as of January 1, 1993, based upon our prior segmentation audit (A-07-94-00804). 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.
- 2/ We obtained Total Company contribution amounts from the actuarial valuation reports and Department of Labor/Internal Revenue Service (DOL/IRS) Forms 5500. 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 pension costs 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 adjustments for prepayment credits and participant 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. We obtained the benefit payments from documents provided by Blue Cross Blue Shield of Kansas (Kansas).
- 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 Kansas. For plan years prior to 1996, our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. 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 as needed to cover funding requirements.
- 8/ We obtained total asset amounts as of February 29, 2008, from documents prepared by Kansas's actuarial consulting firm.
- 9/ The asset variance represents the difference between our calculation of Medicare segment pension assets and Kansas's calculation of the Medicare segment pension assets.

APPENDIX B: EXCESS MEDICARE SEGMENT PENSION LIABILITIES

		Per OIG	Per Kansas	Difference
Medicare segment pension assets as of February 29, 2008	1/	\$9,467,490	\$9,085,222	382,268
Adjustment to Medicare segment pension assets:				
Unallowable Unfunded Pension Costs	2/	257,220	0	257,220
Adjusted Medicare segment pension assets		<u>9,724,710</u>	<u>9,085,222</u>	<u>639,488</u>
Accrued Actuarial Liabilities as of February 29, 2008	3/	11,791,505	11,791,505	0
Adjustment to Accrued Actuarial Liabilities:	4/			
Plan Amendment	5/	(204,457)	0	204,457
Adjusted Actuarial Accrued Liabilities		<u>11,587,048</u>	<u>11,791,505</u>	<u>204,457</u>
Medicare Segment Excess Liabilities	6/	<u>(\$1,862,338)</u>	<u>(\$2,706,283)</u>	<u>\$843,945</u>

FOOTNOTES

1/ We obtained the final market value of Medicare segment pension assets from Appendix A.

2/ Cost Accounting Standard (CAS) 413-50(c)(12)(ii) requires that the market value of the assets be increased by the current value of any unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2).

3/ The accrued actuarial liabilities included lump sums paid to participants in 2008 plus the remaining Medicare segment participants valued as inactive on January 1, 2008, data file rolled forward to February 29, 2008.

4/ CAS 413-50(c)(12)(iv) requires that pension plan improvements adopted within 60 months of the date of the event (plan termination), which increase the actuarial accrued liability, shall be recognized on a prorated basis using the number of months that the date of adoption preceded the event date.

5/ Plan amendment on January 1, 2006, eliminated the participant charge for preretirement death benefits for active participants.

6/ We calculated the Medicare segment excess liabilities due to the termination of the Medicare contract based upon the required adjustments. The Medicare segment excess liabilities represent the adjusted final market value of assets less the adjusted accrued actuarial liability.

**APPENDIX C: CALCULATION OF
AGGREGATE MEDICARE PERCENTAGE**

Fiscal Year 1/	Medicare Segment Pension Costs Charged to Medicare (A)	Total Medicare Segment Pension Costs (B)	Medicare's Aggregate % (A/B) 2/
1991	\$148,293	\$154,569	
1992	252,201	260,754	
1993	320,151	328,293	
1994	452,358	489,883	
1995	397,131	438,480	
1996	435,596	488,172	
1997	407,913	425,752	
1998	95,835	98,932	
1999	0	0	
2000	27,729	28,598	
2001	404,334	415,981	
2002	631,515	649,008	
2003	1,135,290	1,155,276	
2004	1,280,594	1,290,271	
2005	1,497,455	1,498,504	
2006	1,763,656	1,772,162	
2007	1,894,536	1,897,762	
2008	770,181	771,415	
Total	\$11,914,768	\$12,163,812	97.95%

1/ The aggregate percentage was based on the audited pension costs as determined during the pension audits related to the Kansas Medicare segment. The information for fiscal years (FY) 1991 - 1993 was obtained during our prior audit (A-07-94-01105). The information for FYs 1994 - 2008 was obtained during the current review (A-07-09-00309).

2/ We calculated the aggregate Medicare percentage by dividing the Medicare segment pension costs charged to Medicare (numerator) by the total Medicare segment pension costs (denominator) pursuant to Cost Accounting Standard 413.

APPENDIX D: AUDITEE COMMENTS



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March 29, 2010

Report Number: A-07-09-00308

Patrick J. Cogley
Regional Inspector General
For Audit Services
Department of Health & Human Services
Region VII
Room 0429
601 East 12th Street
Kansas City, Missouri 64106

Dear Mr. Cogley:

Enclosed is the Blue Cross and Blue Shield of Kansas (BCBSKS) response to the U.S. Department of Health & Human Services, Office of Inspector General (OIG), draft report entitled *Review of the Qualified Pension Plan at Blue Cross and Blue Shield of Kansas, a Terminated Medicare Contractor, for the Period January 1, 1993 to February 29, 2008*.

Appendix B of the draft report reflects the Medicare Segment Excess Liabilities per OIG's calculation as \$1,862,338, with the difference from BCBSKS' calculation reflected as \$843,945. In the Summary of Findings on page ii, this amount is referenced as \$1,824,160 with the difference from BCBSKS' calculation being referenced as \$882,123. We believe this is a misprint as we find no support for the numbers included in the Summary of Findings.

The following are the OIG's findings with BCBSKS's response:

OIG Finding: Increase Medicare segment pension assets as of February 29, 2008, by \$382,268 and recognize \$9,467,490 as the Medicare segment pension assets.

BCBSKS Response: We concur with this finding.

OIG Finding: Increase its total company pension assets as of February 29, 2008, by \$15,000,000 and recognize \$183,793,500 as the total company pension assets.

BCBSKS Response: We concur with this finding.

Patrick J. Cogley
March 29, 2010
Page Two

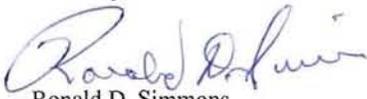
OIG Finding: Decrease Medicare's share of the Medicare segment excess pension liabilities by \$882,123 and submit for reimbursement \$1,824,160 as Medicare's share of the excess liabilities due to the segment closing calculation.

BCBSKS Response: BCBSKS believes this difference should be reduced by \$41,404 to 802,541 (See second paragraph, we believe \$882,123 should be \$843,945). BCBSKS, in consultation with and expertise provided by J.P. Morgan pension actuarial consultants, believes the OIG calculation of Medicare's share of the Medicare segment excess pension liabilities shown in Appendix B is not based on the most accurate information available. We believe the more accurate calculation reflects the difference as \$802,541. The attachment provides rationale for our more accurate calculation and the shortcomings of the OIG calculation.

BCBSKS believes using February 29, 2008 results in an inequitable calculation of Medicare's share of the excess pension liabilities. The Cost Accounting Standards section 413-50(c)(12)(iii) provides that if the use of the contract termination date results in an " inequitable calculation, the contracting parties shall agree on an appropriate date." BCBSKS holds that the contract termination date does in fact result in an inequitable calculation. BCBSKS reserves the right to request consideration of this inequity as part of the resolution of contract proceeding in regards to contract termination funding.

We wish to express our appreciation for the professional manner in which your audit team conducted this audit. Feel free to contact my office (785-291-8893) if you have questions or concerns in regards to our response.

Sincerely,



Ronald D. Simmons
Controller

Medicare Audit Number: A-07-09-00308
March 29, 2010

Medicare's Share of the Medicare Segment Excess Pension Liabilities

BCBSKS More Accurate Alternative Calculation (as prepared by J.P. Morgan)

- matched the OIG's overall Actuarial Accrued Liability (AAL) as of January 1, 2006 by including participants in department codes 862 and 863 (\$16,570,431)
- ran this updated group through J.P. Morgan's valuation system to get the AAL as of January 1, 2006 prior to reflecting the plan amendment eliminating the participant charge for pre-retirement death benefits (\$16,282,690)
- applied the proration of (34/60) to get the revised adjustment amount (\$163,053 = \$287,741 x (34/60))

Issues with OIG Calculation

- the ERISA FSA plan amendment base of \$2,928,231 included both the impact of changes in IRS limits and the pre-retirement death benefit amendment; only the impact of the pre-retirement death benefit amendment should have been measured
- the resulting plan amendment impact was then allocated to the Medicare segment based on the ratio of the unamortized unfunded liabilities under CAS; a ratio based on the Medicare segment AAL to the total AAL may have worked better here
- it appears the proration of (34/60) was applied twice (first to get the overall plan amendment base amount and then again when allocating it to the Medicare segment)