

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF
MEDICARE CONTRACTOR'S
PENSION SEGMENTATION
BLUE CROSS AND BLUE SHIELD
OF OREGON**



JUNE GIBBS BROWN
Inspector General

OCTOBER 1995
CIN: A-07-95-01150



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

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

CIN: A-07-94-01 150

October 25, 1995

Ms. Lisa Johnson, Controller
Blue Cross and Blue Shield of Oregon
100 SW Market Street
PO Box 1271
Portland, Oregon 97207-1271

Dear Ms. Johnson:

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled ***Review of Medicare Contractor's Pension Segmentation, Blue Cross and Blue Shield of Oregon.*** The purpose of our review was to evaluate Blue Cross and Blue Shield of Oregon's (Oregon) compliance with the pension segmentation requirements of its Medicare contract.

Our review showed that Oregon overstated Medicare segment pension assets as of 1986 by \$170,415. The overstatement occurred because Oregon inadvertently used the 1981 rather than the 1984 asset fraction when identifying the January 1, 1986 Medicare assets. However, Oregon's update of the Medicare segment assets from Plan Year 1986 to Plan Year 1994 understated segment assets by \$361,727. The understatement primarily occurred because Oregon used incorrect participant data and did not equitably assign pension contributions.

We recommend that Oregon increase the January 1, 1994 assets of the Medicare segment by \$191,312 (\$361,727 less \$170,415). Oregon agreed with our recommendations and its response is included in its entirety as Appendix B.

INTRODUCTION

BACKGROUND

Oregon has administered Medicare Part A under a cost reimbursement contract since the start of the Medicare program. Oregon also serves as the Common Working File Host (CWFH) for 13 western States under a separate cost reimbursable contract. The contracts, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations

(FPR), and the Cost Accounting Standards (CAS) contain reimbursement principles for cost reimbursement contracts.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. These payments represented allowable pension costs under the FPR and/or the FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

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

The Health Care Financing Administration (HCFA) incorporated segmentation requirements into Medicare contracts starting with Fiscal Year 1988. The contractual language specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment.

Oregon's contract required (1) computing the Medicare segment's actuarial liability, (2) determining the ratio of the Medicare segment's actuarial liability to the total plan actuarial liability (asset fraction), (3) allocating a portion of total pension assets as of 1986 based on the above ratio, (4) updating Medicare pension assets annually, and (5) assessing if Medicare's pension costs should be separately calculated.

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 is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract.**

The contracts also provide for separate identification of the pension assets of the Medicare segment. The identification involves the allocation of assets to the Medicare segment as of the first pension plan year after December 31, 1985 in which the salary criterion was met. The allocation was to use the ratio of the actuarial liabilities of the Medicare segment to the actuarial liabilities of the total plan, as of the later of the first day of the first plan year

starting after December 31, 1980, or the first day of the first pension plan year following the date such Medicare segment first existed.

To ensure that contractors developed and maintained the data necessary for segmentation calculations, HCFA distributed a pension cost questionnaire to contractors in 1989. Oregon's questionnaire response of June 12, 1989 identified total pension assets of \$18,220,299 and Medicare segment assets of \$988,014 as of January 1, 1986. Oregon also concluded that separate valuations for the Medicare segment were required.

Oregon participates in the National Retirement Program administered by the Blue Cross/Blue Shield National Employee Benefits Administration (NEBA). The Wyatt Company, NEBA's actuarial firm, played a major role in the preparation of Oregon's questionnaire response.

SCOPE

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine Oregon's compliance with pension segmentation requirements of its Medicare contract. Achieving the objective did not require a review of Oregon's internal control structure. The audit addressed Oregon's initial determination of pension assets for its Medicare segment and later updates. Our review covered January 1, 1984 to January 1, 1994.

We performed this review in conjunction with our audits of unfunded pension costs (CIN: A-07-95-01 15 1) and pension costs claimed for Medicare reimbursement (CIN: A-07-95-01153). The information obtained and reviewed during those audits was also used in performing this review.

We reviewed Oregon's identification of the Medicare segment as of January 1, 1986 and traced the segment's organizational lineage back to 1984. We also reviewed Oregon's computation of the asset fraction and its update of Medicare assets from January 1, 1986 to January 1, 1994.

In performing the review, we used information provided by NEBA and NEBA's pension actuary. The information included liabilities, normal costs, contributions, expenses, and earnings. We reviewed Oregon's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, we calculated the asset fraction, determined the 1986 Medicare segment assets, and updated the Medicare segment assets to January 1, 1994. The HCFA pension actuarial staff reviewed our methodology and calculations.

We performed site work at Oregon's corporate offices in Portland, Oregon during May 1995. Subsequently, we performed audit work in our Jefferson City and Kansas City, Missouri Offices.

FINDINGS AND RECOMMENDATIONS

MEDICARE ASSETS AS OF JANUARY 1, 1986

We determined that Oregon’s asset fraction was overstated by .9353 percent. Oregon inappropriately used 1981 data for the calculation of the asset fraction. The appropriate year’s data decreased the asset fraction from 5.4226 percent to 4.4873 percent which also decreased the Medicare segment assets by \$170,415 to \$817,599.

Oregon was formed on June 1, 1983 by the merger of Oregon Physician Services Blue Shield (OPS) and Blue Cross of Oregon (BC of Oregon). In calculating the asset fraction, Oregon used 1981 participant liabilities from only BC of Oregon. However, Oregon’s Medicare contract specified that,

... the asset fraction will be the actuarial liabilities, as of the later of the first day of the first pension plan year starting after December 31, 1980, or the first day of the first pension plan year following the date such Medicare Segment first existed...

Oregon’s Medicare segment first existed in 1983. Therefore, the first day of the first pension plan year following the date such segment first existed was January 1, 1984.

We calculated Oregon’s asset fraction using participants’ liabilities as of January 1, 1984. The following schedule shows the details of Oregon’s and our calculations.

	Total Actuarial <u>Liability</u> (A)	Medicare Actuarial <u>Liability</u> (B)	Rounded Asset <u>Fraction</u> (C) (B)/(A)	1986 Total Company <u>Assets</u> (D)	1986 Medicare Segment <u>Assets</u> (E) (C)x(D)
OIG	\$13,849,752	\$621,477	.044873 <u>1/</u>	\$18,220,298	\$ 817,599
Oregon	8,943,226	484,958	<u>.054226</u> <u>2/</u>	<u>18,220,298</u>	<u>988,014</u>
Difference			<u>(.009353)</u>	<u>\$ 0</u>	<u>\$(170,415)</u>

1/ Asset Fraction calculated using participants’ actuarial liabilities as of January 1, 1984.

2/ Asset Fraction calculated using participants’ actuarial liabilities as of January 1, 1981.

Recommendation:

We recommend that Oregon:

- ❶ Decrease the 1986 pension assets of the Medicare segment by \$170,415.

Auditee Response

Oregon agreed with our recommendation.

MEDICARE'S ASSET BASE AS OF
JANUARY 1, 1986 UPDATED TO JANUARY 1, 1994

Oregon's methodology in updating the Medicare segment assets from January 1, 1986 to January 1, 1994 understated the segment assets by \$361,727. This understatement resulted primarily from Oregon misclassifying participants as to segment and non-segment which increased the assets \$472,029. Other factors included correcting payments to retirees (\$907 increase), adjusting the assignment of pension contributions (\$107,942 increase) and revising earnings and expenses (\$219,151 decrease). When considered with the 1986 adjustment, Oregon understated Medicare's pension assets by \$191,312 as of January 1, 1994.

Participants

In the update, Oregon omitted certain cost centers that met the contractual specifications for inclusion in the segment. Additionally, Oregon included participants in cost centers that did not meet the specifications for a segment.

Since the identification of the segment participants was incorrect, transfers (representing the movement into and out of the segment each year) in the updates were incorrect. The following table compares Oregon's and our computations of transfer amounts:

Transfer Adjustments to the Medicare Segment

<u>Year</u>	<u>Oregon</u>	<u>OIG</u>
1986	\$ (38,175)	\$ (46,865)
1987	(105,579)	(6,524)
1988	55,159	(17,143)
1989	117,675	(86,935)
1990	(109,715)	123,638
1991	127,389	(49,422)
1992	(4,407)	6,264
1993	<u>(1,016,884)</u>	<u>(425,521)</u>
Total	<u>\$ (974,537)</u>	<u>\$(502,508)</u>

The corrected identification of the segment participants and transfer amounts was used in updating the Medicare segment assets. See Appendix A. The computation resulted in a net increase of \$472,029 (\$974,537 less \$502,508) in the Medicare segment assets.

Payments to Retirees

Due to incorrect identification of the Medicare segment, Oregon's update of segment assets included lump sum benefit payments to retirees that were not segment participants. We matched benefit payments to individual retirees and included them in our update of segment assets. A comparison of Oregon's and our computed benefit amounts are shown on the following schedule.

Benefit Payments to Medicare Segment Retirees

<u>Year</u>	<u>Oregon</u>	<u>OIG</u>	<u>Variance</u>
1986	\$ 0	\$2,312	\$ (2,312)
1987	0	5,821	(5,821)
1988	53,489	53,489	0
1989	1,762	0	1,762
1990	0	3,013	(3,013)
1991	0	0	0
1992	0	0	0
1993	<u>41,166</u>	<u>30,875</u>	<u>10,291</u>
Total	<u>\$96,417</u>	<u>\$95,510</u>	<u>\$ 907</u>

Corrected benefit payment amounts were used in updating the Medicare segment assets shown in Appendix A. This resulted in a net increase of \$907 in the Medicare segment assets.

Assignment of Pension Contributions

Oregon's update methodology did not equitably assign pension contributions to the Medicare segment. As a result, Oregon understated Medicare segment assets by \$107,942. The understatement primarily occurred because Oregon did not adequately assign contributions to the segment for 1991 through 1993.

For years 1991 through 1993 Oregon's consulting actuary calculated pension costs separately for the total company and the Medicare segment. In 1991, Oregon's consulting actuary calculated negative pension costs for the Medicare segment, therefore no contributions were assigned to the Medicare segment. For years 1992 and 1993 Oregon's actual contributions to the pension trust fund exceeded the total company pension costs calculated by its actuary. However, Oregon did not assign any portion of the excess contributions to the Medicare segment. Instead all the excess contributions were assigned to the "other segment".

Using the pension costs as calculated by the HCFA Office of the Actuary (CIN: A-07-95-01 151), we assigned an equitable portion of the total company contributions to the Medicare segment, based on the ratio of the Medicare segment CAS funding target to the total

company CAS funding target. See Appendix A. Our calculations increased Medicare segment assets by \$107,942.

Allocation of Earnings and Expenses

Oregon's update methodology allocated investment earnings and administrative expenses to the Medicare segment based on a ratio of segment assets to total company assets. Because Oregon's asset amounts were incorrect, it overstated the segment's earnings and expenses for each year of the update. Except for correcting asset amounts, as previously described, we used Oregon's allocation methodology in our update and decreased the Medicare segment assets by \$219,151.

Medicare Assets as of January 1, 1994

The pension assets of the Medicare segment from January 1, 1986 to January 1, 1994 were updated. See Appendix A. The update shows an increase in the Medicare segment assets of \$191,312 as of January 1, 1994. This increase resulted from revising the asset fraction (\$170,415 decrease), correcting the transfer adjustments (\$472,029 increase), adjusting for benefit payments (\$907 increase), correcting the allocation of contributions (\$107,942 increase), and calculating the update with corrected asset amounts (\$219,151 decrease).

Recommendation:

We recommend that Oregon:

- ② Increase the pension assets of the Medicare segment by \$191,312 as of January 1, 1994.

Auditee Response

Oregon agreed with our recommendation.

INSTRUCTIONS FOR **AUDITEE** RESPONSE

Final determinations as to actions to be taken on all matters reported will be made by the HHS action official identified below. We request that you respond to each of the recommendations in this report within 30 days from the date of this report to the HHS action official, presenting any comments or additional information that you believe may have a bearing on final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

Sincerely,



Barbara A. Bennett
Regional Inspector General
for Audit Services

Enclosures

HHS Action Official:

Ms. Nancy Dapper
Regional Administrator, Region X
Health Care Financing Administration
2201 Sixth Ave.
Mail Stop RX40
Seattle, Washington 98121-2500

BLUE CROSS AND BLUE SHIELD OF OREGON
Portland, Oregon
CIN: A-07-95-01 150

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1986 TO JANUARY 1, 1994

Description	Total Plan	Other Segment	Medicare Segment
Assets January 1, 1986 <u>1/</u>	\$18,220,298	\$17,402,699	\$817,599
Contributions <u>2/</u>	354,116	331,436	22,680
Other Transactions	0	0	0
Investment Return <u>3/</u>	2,861,757	2,733,341	128,416
Benefit Payments <u>4/</u>	(1,202,614)	(1,200,302)	(2,312)
Expenses <u>5/</u>	(114,326)	(109,196)	(5,130)
Transfers <u>6/</u>	<u> </u>	<u>46,865</u>	<u>(46,865)</u>
Assets January 1, 1987	\$20,119,231	\$19,204,843	\$914,388
Contributions	216,626	203,535	13,091
Other Transactions	0	0	0
Investment Return	945,598	902,622	42,976
Benefit Payments	(632,607)	(626,786)	(5,821)
Expenses	(134,751)	(128,627)	(6,124)
Transfers	<u> </u>	<u>6,524</u>	<u>(6,524)</u>
Assets January 1, 1988	\$20,514,097	\$19,562,111	\$951,986
Contributions	0	0	0
Other Transactions	0	0	0
Investment Return	2,808,359	2,678,033	130,326
Benefit Payments	(615,510)	(562,021)	(53,489)
Expenses	(141,226)	(134,672)	(6,554)
Transfers	<u> </u>	<u>17,143</u>	<u>(17,143)</u>
Assets January 1, 1989	\$22,565,720	\$21,560,594	\$1,005,126
Contributions	0	0	0
Other Transactions	0	0	0
Investment Return	5,120,017	4,891,960	228,057
Benefit Payments	(674,599)	(674,599)	0
Expenses	(164,495)	(157,168)	(7,327)
Transfers	<u> </u>	<u>86,935</u>	<u>(86,935)</u>
Assets January 1, 1990	\$26,846,643	\$25,707,722	\$1,138,921

BLUE CROSS AND BLUE SHIELD OF OREGON
Portland, Oregon
CIN: A-07-95-01 150

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1986 TO JANUARY 1, 1994

Description	Total Plan	Other Segment	Medicare Segment
Assets January 1, 1990	\$26,846,643	\$25,707,722	\$1,138,921
Contributions	0	0	0
Other Transactions	0	0	0
Investment Return	(672,279)	(643,759)	(28,520)
Benefit Payments	(1,223,940)	(1,220,927)	(3,013)
Expenses	(149,871)	(143,513)	(6,358)
Transfers	<u> </u>	<u>(123,638)</u>	<u>123,638</u>
Assets January 1, 1991	\$24,800,553	\$23,575,885	\$1,224,668
Contributions	530,502	514,807	15,695
Other Transactions	0	0	0
Investment Return	5,330,121	5,066,916	263,205
Benefit Payments	(1,569,534)	(1,569,534)	0
Expenses	(140,591)	(133,649)	(6,942)
Transfers	<u> </u>	<u>49,422</u>	<u>(49,422)</u>
Assets January 1, 1992	\$28,951,051	\$27,503,847	\$1,447,204
Contributions	1,606,488	1,556,724	49,764
Other Transactions	0	0	0
Investment Return	1,127,833	1,071,455	56,378
Benefit Payments	(1,492,843)	(1,492,843)	0
Expenses	(144,734)	(137,499)	(7,235)
Transfers	<u> </u>	<u>(6,264)</u>	<u>6,264</u>
Assets January 1, 1993	\$30,047,795	\$28,495,420	\$1,552,375
Contributions	3,187,726	3,066,456	121,270
Other Transactions	0	0	0
Investment Return	2,907,894	2,757,662	150,232
Benefit Payments	(3,745,472)	(3,714,597)	(30,875)
Expenses	(200,723)	(190,353)	(10,370)
Transfers	<u> </u>	<u>425,521</u>	<u>(425,521)</u>
Assets January 1, 1994	\$32,197,220	\$30,840,109	\$1,357,111
Assets Per Oregon <u>7/</u>	<u>32,197,220</u>	<u>31,031,421</u>	<u>1,165,799</u>
Variance <u>8/</u>	<u>\$ 0</u>	<u>\$(191,312)</u>	<u>\$ 191,312</u>

BLUE CROSS AND BLUE SHIELD OF OREGON
Portland, Oregon
CIN: A-07-95-01 150

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1986 TO JANUARY 1, 1994

FOOTNOTES TO STATEMENT OF MEDICARE PENSION ASSETS

1/ We calculated the Medicare segment assets based on our identification of the Medicare segment and our computed asset fraction (4.4873 %). We computed the asset fraction as explained in our finding section of the report narrative. The amounts shown for the other segment represent the difference between the total company and the Medicare segment.

2/ We obtained total contribution amounts from IRS Form 5500 reports. We allocated the 1986 and 1987 contributions to the Medicare segment based on the ratio of segment participants' normal costs and accrued liability to total company normal costs and accrued liability. Oregon did not make contributions to the pension trust fund for years 1988 through 1990. For years 1991 and after, we allocated contributions to the Medicare segment based on the ratio of the segment's CAS funding target to the total company CAS funding target.

3/ Oregon provided earnings amounts and we verified them to IRS Form 5500 reports. We allocated earnings to the Medicare segment based on the ratio of beginning of year market value of Medicare assets to the beginning of year market value of total assets. Oregon used this same methodology.

4/ Oregon provided benefit payment amounts and we verified them to IRS Form 5500 reports. We used actual benefit payments for Medicare segment retirees.

5/ Oregon provided administrative expense amounts and we verified them to IRS Form 5500 reports. We allocated administrative expenses to the Medicare segment on the ratio of beginning of year market value of Medicare assets to the beginning of year market value of total assets. Oregon used this same methodology.

6/ We identified participant transfers between segments by comparing annual participant valuation listings provided by Oregon. The listings contained the actuarial liability of each participant at year-end. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. We calculated the funding level as the assets divided by the liabilities. If the funding level ratio was greater than one, we transferred assets equal to the participant's liability. Oregon used this same methodology.

7/ We obtained the total asset amounts as of January 1, 1994 from Oregon's update of assets provided by its actuary.

8/ The asset variance represents the difference between the OIG calculation of assets as of January 1, 1994 and the assets calculated by Oregon's actuary.



**Blue Cross BlueShield
of Oregon**

100 SW Market Street
PO Box 1271
Portland, Oregon 97207-1271

503 / 225-5221
1-800-452-7275

APPENDIX Fi

HMO Oregon
(Formerly *Capitol* Health Care)



October 10, 1995

Ms. Barbara A. Bennett
Regional Inspector General for Audit Services
Region VII
Office of Inspector General
Department of Health and Human Services
601 East 12th Street
Room 284 A
Kansas City, MO 64106

Re: CM: A-07-95-01 150
A-07-95-01151
A-07-95-01153

Dear Ms. Bennett:

We have reviewed the draft findings of the Office of Inspector (OIG) Medicare Audit.

We agree with the recommendation (CM: A-07-95-O 1150) that Blue Cross and Blue Shield of Oregon adjust the Medicare segment allocation by increasing the segment assets by \$191,312 as of January 1, 1994.

We agree with the recommendation (CM: A-07-95-01 151) that there are accumulated unfunded pension costs of \$260,335 as of January 1, 1995. After the final drafts have been issued, we will be seeking a reassignment of these costs under the revised CAS 412 and 413. At that time, we will work with HCFA's Office of the Actuary and Blue Cross and Blue Shield Association to reassign these costs to future periods.

We also agree with the findings (CIN: A-07-95-01153) that for fiscal years 1993 and 1994 an additional \$45,664 may be claimed for reimbursement. After the final audits have been issued, we will take the necessary steps to reflect these findings.

Sincerely,

Lisa L. Johnson, CPA
Controller

cc: Steve Hooker
Jim Verdick
Ronald L. Solomon, HCFA, Office of Actuary, Baltimore
Richard M. Snow, HCFA
Robert Rhodes, BCBSA
Carol Navin, BCBSA, NEBA