

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF MEDICARE
CONTRACTOR'S PENSION
SEGMENTATION, ANTHEM BLUE
CROSS AND BLUE SHIELD OF
CONNECTICUT**



JUNE GIBBS BROWN
Inspector General

MARCH 1998
A-07-97-02500



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

CIN: A-07-97-02500

MAR 24 1998

Mr. Phillip Finger
Director of Cost and Budget
Anthem Blue Cross and Blue Shield of Connecticut
370 Bassett Road
North Haven, Connecticut 06473-420 1

Dear Mr. Finger:

This report provides the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Medicare Contractor's Pension Segmentation, Anthem Blue Cross and Blue Shield of Connecticut*. The purpose of our review was to evaluate Anthem Blue Cross and Blue Shield of Connecticut's (Connecticut) compliance with the pension segmentation requirements of its Medicare contract. The audit addressed the update of pension assets during the period January 1, 1991 to January 1, 1996.

Our review showed that Connecticut overstated Medicare segment assets as of January 1, 1996 by \$122,548. We recommend that Connecticut decrease the January 1, 1996 assets of the Medicare segment by \$122,548. Subsequent to our review, Connecticut provided corrected cost center information on four pension plan participants that was not factored into the original segmentation report. Additionally, Connecticut concluded that an entire cost center should be excluded from the Medicare segment. We have corrected the cost center information on four pension plan participants and excluded the entire cost center in our calculations and made the appropriate adjustments.

INTRODUCTION

BACKGROUND

Connecticut has administered Medicare Part A under a cost reimbursement contract since the start of the Medicare program. The contracts, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations (FPR), and the Cost Accounting Standards (CAS) contain reimbursement principles for cost reimbursement contracts.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 plan. 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.

Connecticut'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 contract/agreement; or*
- 2. Less than a majority of the salary dollars is allocated to the Medicare contract/agreement, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare contract/agreement.*

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.

Our previous segmentation review (CIN: A-07-93-00709) addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1986, and the update of the segment's assets to January 1, 1991.

In reports provided for our current review, Connecticut identified total pension assets of \$95,146,501 and Medicare segment assets of \$2,070,374 as of January 1, 1996. Connecticut also concluded that separate valuations for the Medicare segment were required.

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine Connecticut's compliance with pension segmentation requirements of its Medicare contract. Achieving our objective did not require that we review the internal control structure of Connecticut. The audit addressed the update of pension assets during the period January 1, 1991 to January 1, 1996.

We performed this review in conjunction with our audits of unfunded pension costs (CIN: A-07-98-02501) and pension costs claimed for Medicare reimbursement (CIN: A-07-98-02502). The information obtained and reviewed during those audits was also used in performing this review.

We reviewed Connecticut's identification of the Medicare segment and its update of Medicare assets from January 1, 1991 to January 1, 1996.

In performing the review, we used information provided by Connecticut's consulting actuarial firm. The information included liabilities, normal costs, contributions, benefit payments, expenses, and earnings. We reviewed Connecticut's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, we updated the Medicare segment assets to January 1, 1996. The HCFA pension actuarial staff reviewed our methodology and calculations.

We performed site work at Connecticut's corporate offices in North Haven, Connecticut during September 1997. Subsequently, we performed audit work in our Jefferson City, Missouri office.

FINDING AND RECOMMENDATION

As of January 1, 1996 pension assets for Connecticut's Medicare segment were overstated by \$122,548. The overstatement occurred because Connecticut misclassified participants and transfers as to segment and non-segment (\$18,234), incorrectly assigned pension assets to the FEP segment (\$120,739), inequitably assigned pension contributions (\$80,206), and incorrectly allocated earnings and expenses (\$63,781).

Participant Transfers

Connecticut correctly identified the Medicare segment organizational components and cost centers. However, Connecticut misclassified participants in its updates as to segment and non-segment.

Since the classification of participants was incorrect, transfers (representing the movement in and out of the segment each year) were also incorrect. Comparison of transfer amount computations were as follows:

<u>Transfer Adjustments to the Medicare Segment</u>		
<u>Year</u>	<u>Connecticut</u>	<u>OIG</u>
1991	\$2,982	(\$41,880)
1992	\$1,187	\$42,832
1993	(\$3 1,564)	(\$46,583)
1994	\$2,148	\$2,149
1995	(\$1,060)	(\$1,059)
Total	<u>(\$26,307)</u>	<u>(\$44,541)</u>

We corrected the identification of the segment participants and transfer amounts in updating the Medicare assets. See Appendix A. Our corrections to the transfer amount decreased the Medicare segment assets by \$18,234 (\$44,541 less \$26,307).

Federal Employee Program Spin-Off

In 1992, the Office of Personnel Management requested that Connecticut treat the Federal Employee Program (FEP) cost centers within the Medicare segment as a separate segment and perform separate FEP valuations and CAS cost computations. We previously determined cost centers identified as the FEP segment were included in the Medicare segment. Thus, we performed a spin-off of the FEP segment from the Medicare segment as of January 1, 1993 as indicated by the FEP segmentation values developed by Connecticut's actuary.

Our spin-off adjustment, using the FEP segment participants, resulted in an asset transfer of \$390,794 from the Medicare segment to the newly created FEP segment.. Connecticut's spin-off adjustment was a transfer of \$270,055. As a consequence, Connecticut overstated the Medicare segment assets by \$120,739 (\$390,794 less \$270,055).

Pension Contributions

As of January 1, 1993, Connecticut began preparing separate FEP valuations and CAS cost computations. For presentation purposes, Connecticut continued to update the Medicare segment assets including FEP, however, Connecticut also started preparing a separate update of FEP segment assets only.

Connecticut funded their pension plan for years 1993 through 1995, but did not fund the Medicare segment due to the existence of unabsorbed credits (see CIN: A-07-98-02501). Thus, in their update of Medicare segment assets (which included FEP) contributions were not assigned to the Medicare segment. However, in their update of FEP segment assets Connecticut assigned contributions totaling \$80,206 for years 1993 through 1995 to FEP.

Mathematically, for Connecticut to assign positive contributions of \$80,206 to FEP, they would have had to assign negative contributions to Medicare of \$80,206. Using our calculation of the separate CAS computations for both Medicare and FEP we did not assign any contributions to the Medicare segment for years 1993 through 1995. Thus, Connecticut had understated Medicare segment assets by \$80,206.

Earnings and Expenses

Connecticut's update methodology allocated earnings and broker expenses to the Medicare segment based on the ratio of the beginning of year market value of Medicare assets to beginning of year market value of total assets. Connecticut allocated the administrative expenses to the Medicare segment based on the ratio of active Medicare segment employees to total active employees. Because Connecticut's asset amounts and participant identifications were incorrect, it overstated the segment's earnings and expenses. Except for correcting asset amounts and participant identifications, as previously described, we used Connecticut's allocation methodology in our update and decreased the Medicare segment assets by \$63,781.

Appendix A provides detailed computations updating pension assets for the Medicare segment from January 1, 1991 to January 1, 1996. The net effect is a \$122,548 decrease in pension assets of the Medicare segment as of January 1, 1996. The decrease resulted from: (1) adjusting for participants that moved in and out of the Medicare segment (\$18,234 decrease), (2) correcting the spin-off adjustment (\$120,739 decrease), (3) equitably assigning pension contributions to the Medicare segment (\$80,206 increase), and (4) revising earnings and expenses (\$63,781 decrease).

Recommendation:

We recommend that Connecticut:

1. Decrease the pension assets of the Medicare segment by \$122,548 as of January 1, 1996.

Auditee Response

Connecticut did not concur with our findings and the resulting recommendation. Their response which is attached (Appendix B) in its entirety raises four specific objections to our recommendation. These objections are summarized below in the order in which they were presented:

1. The finding on participant transfers was incorrect due to an error on their part; furthermore, Connecticut concluded that the transfer adjustments as originally prepared by their actuaries were correct.
2. Agreed with our methodology for spinning off assets for the FEP segment, however due to excessive transfers in 1991 and 1992, the FEP asset spin-off was overstated.
3. Agreed that FEP exists independent of the Medicare segment, however stated that positive contributions to FEP should not have any impact on the Medicare assets.
4. All of the above objections will affect the earnings and expenses year by year.

OIG Response

Subsequent to our review, Connecticut provided us with additional information that lead to the correction of cost center information on four pension plan participants and the exclusion of one cost center from the identification of the Medicare segment. We corrected this cost center information and excluded one cost center from our identification of the Medicare segment and made the appropriate adjustments.

Our transfer analysis (as adjusted in response to Connecticut's comments on our draft report) included only the Medicare cost centers that were agreed to by Connecticut. With the correction of the cost center information and the exclusion of one cost center from our identification of the Medicare segment the transfer variances have been reduced.

Our methodology for spinning off assets for the FEP segment, which Connecticut agreed with, utilized an allocation based on the ratio of market value of assets to actuarial liability. Correction of cost center information and exclusion of one cost center from our identification of the Medicare segment resulted in less transfers into the Medicare segment, thus a smaller actuarial

liability for the Medicare segment. The smaller actuarial liability for the Medicare segment results in a higher ratio used to spin off assets for FEP segment and understated the FEP asset spin-off, not overstated as concluded by Connecticut.

As previously stated for years 1993 through 1995 Connecticut for presentation purposes prepared two updates of Medicare segment assets. One update presented FEP and Medicare as one segment combined, in this update no contributions were assigned the one segment. The second update presented FEP and Medicare as separate segments, in this update contributions totaling \$80,206 were assigned to FEP. The total contribution amount remained unaffected by these presentations. So mathematically, for Connecticut to assign positive contributions of \$80,206 to FEP, they would have had to assign negative contributions of \$80,206 to Medicare.

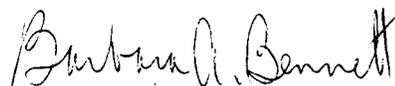
Correction of the cost center information for four pension plan participants and the exclusion of one cost center from our identification of the Medicare segment resulted in changes in the earnings and expenses each year. We have made the appropriate adjustments.

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 the recommendation 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, Region VII

Enclosures

HHS Action Official:

Ms. Judy Berek
Acting Regional Administrator, Region I
Health Care Financing Administration
John F. Kennedy Federal Building, Room 2325
Boston, Massachusetts 02203-0003

ANTHEM BLUE CROSS AND BLUE SHIELD OF CONNECTICUT

CIN: A-07-97-02500

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1991 TO JANUARY 1, 1996

Description		Total Company	Other Segment	Medicare Segment	FEP Segment
Assets January 1, 1991	<u>1/</u>	\$61,375,807	\$59,700,708	\$1,675,099	N/A
Contributions	<u>2/</u>	so	so	\$0	N/A
Earnings	<u>3/</u>	\$8,208,102	\$7,984,082	\$224,020	N/A
Benefit Payments	<u>4/</u>	(\$3,780,530)	(\$3,749,671)	(\$30,859)	N/A
Administrative Expense	<u>5/</u>	(\$280,169)	(\$273,314)	(\$6,855)	N/A
Brokers Expense	<u>6/</u>	(\$171,516)	(\$166,835)	(\$4,681)	N/A
Transfers	<u>7/</u>	\$0	\$41,880	(\$41,880)	N/A
Assets January 1, 1992		\$65,351,694	\$63,536,850	\$1,814,844	N/A
Contributions		so	so	\$0	N/A
Earnings		\$4,933,195	\$4,796,198	\$136,997	N/A
Benefit Payments		(\$4,686,167)	(\$4,520,367)	(\$165,800)	N/A
Administrative Expense		(\$241,690)	(\$237,065)	(\$4,625)	N/A
Brokers Expense		(\$175,227)	(\$170,361)	(\$4,866)	N/A
Transfers		\$0	(\$42,832)	\$42,832	N/A
Assets January 1, 1993		\$65,181,805	\$63,362,423	\$1,819,382	N/A
FEP Spin-Off	<u>8/</u>	\$0	\$0	(\$390,794)	\$390,794
Assets January 1, 1993		\$65,181,805	\$63,362,423	\$1,428,588	\$390,794

ANTHEM BLUE CROSS AND BLUE SHIELD OF CONNECTICUT

CIN: A-07-97-02500

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1991 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare Segment	FEP Segment
Assets January 1, 1993	\$65,181,805	\$63,362,423	\$1,428,588	\$390,794
Contribution	\$6,000,000	\$6,000,000	\$0	\$0
Earnings	\$7,786,994	\$7,569,640	\$170,667	\$46,687
Benefit Payments	(\$4,309,156)	(\$4,302,072)	(\$7,084)	\$0
Administrative Expense	(\$244,695)	(\$239,991)	(\$3,477)	(\$1,227)
Brokers Expense	(\$191,503)	(\$186,158)	(\$4,197)	(\$1,148)
Transfers	so	\$41,983	(\$46,583)	\$4,600
Assets January 1, 1994	\$74,223,445	\$72,245,825	\$1,537,914	\$439,706
Contribution	\$6,800,000	\$6,800,000	\$0	so
Earnings	(\$1,392,632)	(\$1,355,527)	(\$28,855)	(\$8,250)
Benefit Payments	(\$8,867,336)	(\$8,740,751)	(\$7,054)	(\$119,531)
Administrative Expense	(\$301,899)	(\$295,756)	(\$4,444)	(31,699)
Brokers Expense	(\$184,769)	(\$179,846)	(\$3,828)	(\$1,095)
Transfers	\$0	(\$32,633)	\$2,149	\$30,484
Assets January 1, 1995	\$70,276,809	\$68,441,312	\$1,495,882	\$339,615

ANTHEM BLUE CROSS AND BLUE SHIELD OF CONNECTICUT

CIN: A-07-97-02500

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1991 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare Segment	FEP Segment
Assets January 1, 1995	\$70,276,809	\$68,441,312	\$1,495,882	\$339,615
Prepayment Transfer <u>9/</u>	\$0	(313,843)	\$0	\$13,843
Contribution	\$6,600,000	\$6,600,000	\$0	\$0
Earnings	\$22,352,642	\$21,764,430	\$475,789	\$112,423
Benefit Payments	(\$3,524,400)	(\$3,512,075)	(\$12,325)	\$0
Administrative Expense	(\$273,542)	(\$267,265)	(\$4,394)	(\$1,883)
Broker Expense	(\$285,008)	(\$327,508)	(\$56,067)	(\$1,433)
Transfers	\$0	(\$14,053)	(\$1,059)	\$15,112
Assets January 1, 1996	\$95,146,501	\$92,720,998	\$1,947,826	\$477,677
Per Connecticut <u>10/</u>	\$95,146,501	\$92,717,624	\$2,070,374	\$358,503
Variance <u>11/</u>	\$0	\$3,374	(512,548)	\$119,174

FOOTNOTES

1/ We calculated the January 1, 1991 Medicare segment assets during our previous segmentation review. 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. Connecticut did not make contributions to the pension trust fund for years 1991 and 1992. For years 1993 through 1995, 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. The CAS funding target is computed in our report of unfunded pension costs (CIN: A-07-98-02501).

ANTHEM BLUE CROSS AND BLUE SHIELD OF CONNECTICUT

CIN: A-07-97-02500

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1991 TO JANUARY 1, 1996

3/ We obtained earnings from actuarial valuation reports. We allocated earnings to the Medicare segment and later to the FEP segment based on the ratio of the beginning of year market value of Medicare assets and FEP assets to beginning of year market value of total assets. Connecticut used this same methodology.

4/ We obtained total benefit payments from actuarial valuation reports. We based the Medicare segment's benefit payment and the FEP segment's benefit payments on actual payments to both Medicare and FEP retirees, respectively.

5/ We obtained administrative expenses from actuarial valuation reports. We allocated administrative expenses to the Medicare segment and later to the FEP segment based on the ratio of active Medicare and FEP segment employees to total active employees. Connecticut used this same methodology.

6/ We obtained brokers expense from IRS Form 5500 reports. We allocated the brokers expense to the Medicare segment and later to the FEP segment based on the ratio of the beginning of year market value of Medicare assets and FEP assets to beginning of year market value of total assets. Connecticut used this same methodology.

7/ We identified participant transfers between segments by comparing annual participant valuation listings provided by Connecticut. 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. Connecticut used this same methodology.

8/ OPM requested that Connecticut separately account for the FEP segment starting with January 1, 1993. Immediately prior to the spin-off, the market value of assets was 131.21% of the actuarial liability. To maintain the funding level in accordance with CAS 413-50(c)(3), we transferred assets equal to 131.32% of the liability for the FEP segment participants.

9/ Prepayment credit is created when the contributions made to the pension trust fund exceed the CAS pension cost. The prepayment remains unassigned and accumulates interest in the pension trust fund until needed to fund future CAS pension costs. We allocated the prepayment in proportion to the CAS pension costs.

ANTHEM BLUE CROSS AND BLUE SHIELD OF CONNECTICUT

CIN: A-07-97-02500

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1991 TO JANUARY 1, 1996

10/ We obtained total asset amounts as of January 1, 1996 from Connecticut's update of assets provided by its actuary.

11/ The variance represents the difference between the OIG calculation of assets as of January 1, 1996 and the assets calculated by Connecticut's actuary.



February 6, 1998

Mr. Jack Morman
OIG Office of Audit Services, Region VII
601 East 12th Street
Room 284A
Kansas City, MO 64106

Re: CIN: A-07-97-02500
CIN: A-07-98-0250 1
CIN: A-07-98-02502

Dear Jack:

This letter responds to the audit of the Medicare segment of the Blue Cross Blue Shield of Connecticut, Inc. Employees' Retirement Plan which was conducted by your office last year. We have reviewed your **draft** reports and our conclusions follow:

CIN: A-07-97-02500 - Pension Segmentation

- **Participant Transfers** - We do not concur with the reports findings on participant transfers. As you are now aware, BCBS erred when providing you with cost center information and has subsequently provided you with the correction information. We believe the transfer calculations as originally prepared by our actuaries are correct.
- **Federal Employee Program Spin-off** - We agree with your methodology for spinning off assets for the FEP segment, but given that your January 1, 1993 Medicare assets are overstated due to the excessive transfers in 1991 and 1992, the FEP asset spin-off is also overstated.
- **Pension Contributions** - Given that we agree with your methodology for the FEP spin-off, FEP is no longer a sub-segment of the Medicare segment. The FEP segment exists independent of the Medicare segment. Therefore, positive contributions to FEP should not have any impact on the Medicare assets.
- **Earnings and Expenses** - The above stated revisions will affect the earnings and expenses year by year.

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Mr. Jack Morman
OIG Office of Audit Services, Region VII

CIN: A-07-98-02501 - Unfunded Pension Cost

- **Unallowable Direct Pension Costs** - We concur with your methodology, but a revision of the participant transfer data will **affect** the amount allocated to the FEP segment.
- BCBS has filed a request with HCFA to **allow** recapture of the Unallowable Direct Pension Costs and use of the Fresh Start approach. If needed, we will **also** request use of the \$0 floor on pension costs and the reassignment of negative pension costs. Karen Claggett at **HCFA**, Division of Accounting, has informed us that they will not act on our request until this audit is closed.
- **Unabsorbed Credits** - Recalculation of the CAS pension costs due to revised transfer information will impact the unabsorbed credit amount.

CIN: A-07-98-02502 - CAS Pension Cost Claimed for Medicare Reimbursement

- Revisions to the participant transfer data and the **FEP** asset spin-off **will affect** the CAS pension costs for each of the years.

I understand that your are considering whether or not to change the results presented in the draft audit report to reflect the corrected data. We believe that the **final** audit report should use the corrected data. The corrections will more accurately reflect the actual CAS costs we have incurred. In addition, our actuaries have used the correct data, and will have to revise their records based upon the incorrect data if the audit stays as originally drafted.

Please **call** me if we can be of additional assistance.

Sincerely,



Phil Finger

cc: Ronald O. Schlee