



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

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

MAR 29 2007

Report Number: A-07-06-00208

Mr. Dan Bloodworth
Senior Vice President and Chief Financial Officer
Pinnacle Business Solutions, Inc.
515 Pershing Boulevard
North Little Rock, Arkansas 72114

Dear Mr. Bloodworth:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Pension Costs Claimed for Medicare Reimbursement by Arkansas Blue Cross Blue Shield for Fiscal Years 1997 Through 1998." A copy of this report will be forwarded to the HHS action official noted on the next page for his review and any action deemed necessary.

The HHS action official will make final determination regarding actions taken on all matters in the report. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. § 552, as amended by Public Law 104-231), OIG reports are made available to the public to the extent the information is not subject to exemptions of the Act that the Department chooses to exercise (see 45 CFR part 5).

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or 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-07-06-00208 in all correspondence.

Sincerely,

A handwritten signature in black ink that reads "Patrick J. Cogley". The signature is stylized and written in a cursive script.

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Dr. Randy Farris
Regional Administrator, Region VI
Centers for Medicare & Medicaid Services
1301 Young Street, Suite 714
Dallas, Texas 75202

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF PENSION COSTS
CLAIMED FOR MEDICARE
REIMBURSEMENT BY ARKANSAS
BLUE CROSS BLUE SHIELD
FOR FISCAL YEARS 1997
THROUGH 1998**



Daniel R. Levinson
Inspector General

March 2007
A-07-06-00208

Office of Inspector General

<http://oig.hhs.gov>

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

OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

Arkansas Blue Cross Blue Shield (Arkansas) administers both Medicare Part A and Part B operations under the cost reimbursement contracts with Centers for Medicare & Medicaid Services. On March 16, 1998, Arkansas's Board of Directors voted to terminate its qualified defined benefit pension plan effective June 30, 1998; however, distributions of the participants' accrued benefits were not made until May 1, 1999.

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

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

OBJECTIVE

Our objective was to determine the allowability of pension costs that Arkansas claimed for Medicare reimbursement for fiscal years (FY) 1997 through 1998.

SUMMARY OF FINDING

Arkansas claimed \$126,636 of unallowable Medicare pension costs for FYs 1997 through 1998 primarily due to the use of the Financial Accounting Standard No. 87 expense for the calculation of the Other segment allowable pension costs instead of separately computing CAS pension costs as required by the Medicare contract. Arkansas claimed \$2,454,110 of pension costs for Medicare reimbursement; however, we calculated the allowable CAS pension costs during this period to be \$2,327,474.

RECOMMENDATION

We recommend that Arkansas revise its Final Administrative Cost Proposals for FYs 1997 through 1998 to reduce its claimed pension costs by \$126,636.

AUDITEE'S COMMENTS

In written comments on our draft report, Arkansas agreed with our recommendation. Arkansas's response is included in its entirety as Appendix C.

INTRODUCTION

BACKGROUND

Arkansas

Arkansas Blue Cross Blue Shield (Arkansas) administers both Medicare Part A and Part B operations under the cost reimbursement contracts with Centers for Medicare & Medicaid Services (CMS). On March 16, 1998, Arkansas's Board of Directors voted to terminate its qualified defined benefit pension plan effective June 30, 1998; however, distributions of the participants' accrued benefits were not made until May 1, 1999.

Medicare

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

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

Regulations

The Medicare contracts address the determination and allocation of pension costs. The contracts state: "The calculation of and accounting for pension costs charged to this agreement/contract are governed by the Federal Acquisition Regulations and Cost Accounting Standards 412 and 413."

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

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

The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine the allowability of pension costs claimed by Arkansas for Medicare reimbursement for FYs 1997 through 1998.

Scope

We reviewed pension costs claimed for Medicare reimbursement on Arkansas's Final Administrative Cost Proposals (FACP) for FYs 1997 through 1998. Achieving the objective did not require that we review Arkansas's overall internal control structure. However, we did review the internal controls related to the pension costs claimed for Medicare reimbursement to ensure that the pension costs were allocable in accordance with the CAS and allowable in accordance with the FAR.

We performed fieldwork at Arkansas's office in Little Rock, Arkansas, during February 2006.

Methodology

We identified Arkansas's CAS pension costs for the total company and the Medicare segment. We also determined the extent to which Arkansas funded CAS pension costs with contributions to the pension trust fund and accumulated prepayment credits. The calculations were based on separately computed CAS pension costs for the Medicare segment and total company CAS pension costs. The CMS Office of the Actuary calculated the allocable CAS pension costs based on Arkansas's historical practices and on the results of our segmentation review "Review of Medicare Contractor's Pension Segmentation Requirements at Arkansas Blue Cross Blue Shield and Pension Plan Termination" (A-07-06-00206). Appendix A contains details on the pension costs and contributions.

In performing our review, we used information that Arkansas's actuarial consulting firm provided. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We examined Arkansas's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s.

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

FINDING AND RECOMMENDATION

Arkansas claimed \$126,636 of unallowable Medicare pension costs for FYs 1997 and 1998.

We calculated the allowable pension costs based on separately computed CAS pension costs for the Medicare segment and the total company. For FYs 1997 through 1998, Arkansas claimed pension costs of \$2,454,110 for Medicare reimbursement; however, we determined the allowable CAS pension costs were \$2,327,474.

We compared allowable CAS pension costs with the pension costs claimed on Arkansas's FACPs, as shown in the table below.

<u>Cost Claimed Variance</u>			
<u>Fiscal Year</u>	<u>Per OIG</u>	<u>Per Arkansas</u>	<u>Difference</u>
1997	1,476,316	1,594,292	(\$117,976)
1998	851,158	859,818	(\$8,660)
Total	\$2,327,474	2,454,110	(\$126,636)

We determined that the overclaim occurred primarily due to Arkansas's use of the Financial Accounting Standard No. 87 expense to determine the allowable pension costs for the Other segment instead of separately computing CAS pension costs as required by the Medicare contract. As a result, Arkansas claimed \$126,636 of unallowable pension costs.

RECOMMENDATION

We recommend that Arkansas revise its FACPs for FYs 1997 through 1998 to reduce its claimed pension costs by \$126,636.

AUDITEE'S COMMENTS

In written comments on our draft report, Arkansas agreed with our recommendation. Arkansas's response is included in its entirety as Appendix C.

APPENDIXES

**ARKANSAS BLUE CROSS BLUE SHIELD
STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEAR 1997 THROUGH 1998**

Date	Description	Total Company	Other Segment	Medicare Segment
1996	Contributions	<u>1/</u> \$4,792,258	\$4,792,258	\$0
8.00%	Discount For Interest	<u>2/</u> (250,759)	(250,759)	0
	Present Value Contributions	<u>3/</u> 4,541,499	4,541,499	0
	Prepayment Credit	<u>4/</u> 3,861,864	2,696,661	1,165,203
	Present Value Of Funding	<u>5/</u> 8,403,363	7,238,160	1,165,203
	CAS Funding Target	<u>6/</u> 3,861,864	2,696,661	1,165,203
	Percentage Funded	<u>7/</u>	100.00%	100.00%
	Funded Pension Cost	<u>8/</u>	2,696,661	1,165,203
	Allowable Interest	<u>9/</u>	0	0
	Allocable Pension Cost	<u>10/</u>	2,696,661	1,165,203

1997	Contributions	\$3,678,900	\$3,678,900	\$0
8.00%	Discount For Interest	(147,619)	(147,619)	0
	Present Value Contributions	3,531,281	3,531,281	0
	Prepayment Credit	4,562,191	3,252,912	1,309,279
	Present Value Of Funding	8,093,472	6,784,193	1,309,279
	CAS Funding Target	4,562,191	3,252,912	1,309,279
	Percentage Funded		100.00%	100.00%
	Funded Pension Cost		3,252,912	1,309,279
	Allowable Interest		0	0
	Allocable Pension Cost		3,252,912	1,309,279
1997	Fiscal Year Pension Cost	<u>11/</u>	3,113,849	1,273,260
	Medicare LOB Percentage *	<u>12/</u>	4.91%	93.16%
	Additional Allowable Cost	<u>13/</u> \$137,257	10,770	126,487
1997	Allowable Pension Cost	<u>14/</u> <u>\$1,476,316</u>	<u>163,660</u>	<u>1,312,656</u>

**ARKANSAS BLUE CROSS BLUE SHIELD
STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEAR 1997 THROUGH 1998**

Date	Description	Total Company	Other Segment	Medicare Segment
1998	Contributions	\$2,063,254	\$2,063,254	\$0
8.00%	Discount For Interest	<u>(109,322)</u>	<u>(109,322)</u>	0
	Present Value Contributions	1,953,932	1,953,932	0
	Prepayment Credit	<u>2,130,518</u>	<u>1,544,325</u>	586,193
	Present Value Of Funding	4,084,450	3,498,257	586,193
	CAS Funding Target	2,130,518	1,544,325	586,193
	Percentage Funded		<u>100.00%</u>	<u>100.00%</u>
	Funded Pension Cost		1,544,325	586,193
	Allowable Interest		<u>0</u>	<u>0</u>
	Allocable Pension Cost		1,544,325	586,193
1998	Fiscal Year Pension Cost		1,971,472	766,965
	Medicare LOB Percentage *		<u>5.78%</u>	<u>96.12%</u>
1998	Allowable Pension Cost	<u>\$851,158</u>	<u>113,951</u>	<u>737,207</u>

* Line of business.

FOOTNOTES

1/ We obtained total company contribution amounts and dates of deposit from Internal Revenue Service Form 5500 reports. The contributions included deposits made during the plan year and accrued contributions deposited after the end of the plan year but within the time allowed for filing tax returns. The contributions allocated to the Medicare segment were determined during the pension segmentation review (A-07-06-00206). The amounts shown for the Other segment represent the difference between the total company and the Medicare segment.

2/ We subtracted the interest that is included in the contributions deposited after January 1 of each year to discount the contributions back to their beginning of the year value. For purposes of this appendix, we computed the interest as the difference between the present value of contributions at the valuation interest rate and actual contribution amounts.

**ARKANSAS BLUE CROSS BLUE SHIELD
STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEAR 1997 THROUGH 1998**

- 3/ The present value of contributions is the value of the contributions discounted from the date of deposit back to January 1. For purposes of this appendix, we deemed deposits made after the end of the plan year to have been made on the final day of the plan year, consistent with the method mandated by the Employee Retirement Income Security Act of 1974 (ERISA).
- 4/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year Cost Accounting Standards (CAS) funding target. A prepayment credit may be carried forward, with interest, to the first of each subsequent plan year until needed to fund future CAS pension costs. The accumulated value of prepayment credits is available as of the first day of the plan year and is applied as of the first day of the plan year to cover the cost assigned to the period.
- 5/ The present value of funding represents the present value of contributions plus accumulated prepayment credits. This is the amount of funding that is available to cover the CAS funding target measured at the first day of each plan year.
- 6/ The CAS funding target must be funded by accumulated prepayment credits or current year contributions to satisfy the funding requirement of the Federal Acquisition Regulations (FAR) 31.205-6(j)(2)(i).
- 7/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Since any funding in excess of the CAS funding target is considered premature funding in accordance with CAS 412.50(c)(1) (as amended), the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS funding target. For purposes of illustration, the percentage of funding has been rounded to four decimals.
- 8/ We computed the funded CAS pension cost as the CAS funding target multiplied by the percent funded.
- 9/ We assumed that interest on the funded CAS pension cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(j)(2)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target, less the prepayment credit, was funded in four equal installments deposited within 30 days of the end of the quarter.
- 10/ The allocable CAS pension cost is the amount of pension cost that may be allocated for contract cost purposes.

**ARKANSAS BLUE CROSS BLUE SHIELD
STATEMENT OF ALLOWABLE PENSION COSTS
FOR FISCAL YEAR 1997 THROUGH 1998**

- 11/ We converted the plan year (January 1 through December 31) allowable pension costs to a Federal fiscal year (FY) basis (October 1 through September 30). We calculated the FY pension costs as 1/4 of the prior year's costs plus 3/4 of the current year's costs. Costs charged to the Medicare contract should consist of the Medicare segment's direct pension costs plus pension costs attributable to indirect Medicare operations.
- 12/ We calculated allowable pension costs of the Medicare and other segment based on the Medicare line of business percentage (LOB) of each segment. We obtained the percentages from documents provided by Arkansas.
- 13/ An Advance Agreement between CMS and Arkansas approved additional costs to the calendar year (CY) 1996 pension costs. The parties agreed, based upon the revised CAS, that previously unfunded unallowable pension costs which had been excluded from the calculation of the CAS pension costs were now reassignable unfunded pension costs. Beginning as of January 1, 1996, those reassignable unfunded pension costs would be amortized over 10 years; thus they would now be included as a component of the CAS pension costs. This cost (see Appendix B) is allowable in the fourth quarter of CY 1996 since the January through September pension costs have been reported in the prior costs claimed report (A-07-98-02525) and are closed.
- 14/ We computed the allowable Medicare pension cost as the FY pension cost multiplied by the Medicare line of business percentage.

**ARKANSAS BLUE CROSS BLUE SHIELD
CHANGE IN CALENDAR YEAR 1996 PENSION COSTS DUE TO
EXECUTION OF THE ADVANCED AGREEMENT**

Date	Description		Total Company	Other Segment	Medicare Segment
1996	Prior Allocable Pension Costs	<u>1/</u>	3,388,358	2,404,187	984,171
	Current Allocable Pension Costs	<u>2/</u>	3,861,864	<u>2,696,661</u>	<u>1,165,203</u>
	Calendar Year Allocable Difference	<u>3/</u>		292,474	181,032
1996	January - September Allocable Pension Costs	<u>4/</u>		219,356	135,774
	Medicare LOB* Percentage	<u>5/</u>		<u>4.91%</u>	<u>93.16%</u>
1996	January - September Allowable Pension Costs	<u>6/</u>	<u>137,257</u>	<u>10,770</u>	<u>126,487</u>

* Line of business.

FOOTNOTES

- 1/ We obtained the prior allocable pension costs from the prior issued Arkansas Blue Cross Blue Shield costs claimed pension report (A-07-98-02525).
- 2/ We obtained the current allocable pension costs from the development of the 1996 pension costs as documented in Appendix A.
- 3/ We calculated the difference between the prior allocable pension costs and the current allocable pension costs.
- 4/ To determine the additional allocable calendar year (CY) 1996 pension costs attributable to January 1 through September 30, we multiplied the CY allocable difference by 3/4.
- 5/ We calculated allowable pension costs of the Medicare and Other segment based on the Medicare line of business (LOB) percentage of each segment. We obtained the percentages from documents provided by Arkansas. We used the line of business percentages determined for Federal fiscal year 1997 since these additional costs are allowable for the 1997 Federal fiscal year.
- 6/ We computed the January through September additional allowable Medicare pension costs as the January through September allocable pension costs multiplied by the Medicare line of business percentage.



Arkansas
BlueCross BlueShield

601 S. Gaines St.
P.O. Box 2181
Little Rock, Arkansas 72207-2181

March 14, 2007

Patrick J. Cogley
Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Inspector General
Offices of Audit Services
Region VII
601 East 12th Street, Room 284A
Kansas City, MO 64108

Subject: Report Number: A-07-06-00208

Dear Mr. Cogley:

On behalf of Dan Bloodworth, Chief Financial Officer of Pinnacle Business Solutions, Inc., I am responding to the draft report entitled "Review of Pension Costs Claimed for Medicare Reimbursement by Arkansas Blue Cross and Blue Shield for Fiscal Years 1997 through 1998". I have been in communication with Megan Sechafer and Jenenne Tambke regarding this report and want to express my appreciation to them for allowing me the extended time to respond due to other on-going audits here in Arkansas.

We are in agreement with the finding that Arkansas Blue Cross and Blue Shield (ABCBS) claimed \$126,636 of unallowable Medicare pension costs for FYs 1997 through 1998 as noted in the draft report.

I am not submitting a corrective action plan since this report is for the termination of the pension plan and thus no further reporting of defined benefit pension plan costs will occur.

Again, it has been a pleasure to work with Megan and Jenenne during this audit, and we look forward to a final closing agreement in the near future. Should you need anything further, please let me know.

**Report Number: A-07-06-00208
Response to Draft Audit Report
March 14, 2007**

We look forward to a final closing agreement in the near future. Should you need anything further, please let me know.

Sincerely,

Beverly C. Villines
**Beverly C. Villines, Director
Corporate Accounting
Arkansas Blue Cross and Blue Shield**

**cc: Dan Bloodworth, Sr. Vice President and
Chief Financial Officer
Pinnacle Business Solutions, Inc.**