



APR 26 2007

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

Report Number: A-07-07-00226

Eric Schindler, Vice President and Chief Financial Officer  
Blue Cross Blue Shield of Montana  
404 Fuller Avenue  
Helena, Montana 59604

Dear Mr. Schindler:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) report entitled "Review of Medicare Contractor's Pension Segmentation Requirements at Blue Cross Blue Shield of Montana for January 1, 1987 to January 1, 2004." A copy of this report will be forwarded 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 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](mailto:Jenenne.Tambke@oig.hhs.gov). Please refer to report number A-07-07-00226 in all correspondence.

Sincerely,

Patrick J. Cogley  
Regional Inspector General  
for Audit Services

Enclosures

**Direct Reply to HHS Action Official:**

Mr. George Mills  
Regional Administrator (Acting), Region VIII  
Centers for Medicare & Medicaid Services  
Colorado State Bank Building  
1600 Broadway, Suite 700  
Denver, Colorado 80202

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE  
CONTRACTOR'S PENSION  
SEGMENTATION REQUIREMENTS  
AT BLUE CROSS BLUE SHIELD  
OF MONTANA FOR JANUARY 1,  
1987 TO JANUARY 1, 2004**



Daniel R. Levinson  
Inspector General

April 2007  
A-07-07-00226

# ***Office of Inspector General***

<http://oig.hhs.gov>

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## **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**

Blue Cross Blue Shield of Montana (Montana) administers Medicare Part A and B operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS). Effective March 1, 1986, Blue Cross of Montana merged with Montana Physicians' Service, and the two companies became Blue Cross and Blue Shield of Montana. The two pension plans merged effective January 1, 1987.

Starting with fiscal year 1988, CMS incorporated segmentation requirements into Medicare contracts. The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the segment. Additionally, the contract requires Medicare segment assets to be updated for each year after the initial allocation in accordance with Cost Accounting Standards (CAS) 412 and 413.

### **OBJECTIVE**

Our objective was to determine whether Montana complied with the Medicare contracts' pension segmentation requirements while:

- identifying the Medicare segment's initial asset allocation, and
- updating the Medicare segment's assets from the initial asset allocation to January 1, 2004.

### **SUMMARY OF FINDINGS**

Montana did not comply with the Medicare contract's pension segmentation requirements when identifying the Medicare segment's initial asset allocation, and while updating Medicare segment assets from January 1, 1987, to January 1, 2004. As a result, Montana overstated the January 1, 2004, Medicare segment pension assets by \$1,016,181. The overstatement occurred primarily because Montana omitted benefit payments in its rollup of segment assets.

### **RECOMMENDATIONS**

We recommend that Montana:

- decrease Medicare segment pension assets by \$1,016,181 as of January 1, 2004, and
- implement controls to ensure that the Medicare segment's assets are updated in accordance with the Medicare contracts.

## **AUDITEE'S COMMENTS**

In written comments on our draft report, Montana partially concurred with our recommendation to decrease Medicare segment pension assets by \$1,016,181. While Montana stated that its actuaries had already corrected the omission of the 2003 Medicare segment benefit payments, it questioned our January 1, 1987 initial asset allocation date.

In addition, Montana agreed to update future Medicare segment assets in accordance with the Medicare contracts. Montana's response is included in its entirety as Appendix B.

## **OFFICE OF INSPECTOR GENERAL'S RESPONSE**

After reviewing Montana's comments, we continue to believe that Montana should decrease Medicare segment pension assets by \$1,016,181. Our calculations followed the Medicare contract in using January 1, 1987 as the Medicare segment's initial asset allocation date.

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## **Glossary of Abbreviations and Acronyms**

Montana	Blue Cross Blue Shield of Montana
CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
OIG	Office of Inspector General
WAV	weighted average method

# INTRODUCTION

## BACKGROUND

### Montana

Blue Cross Blue Shield of Montana (Montana) administers Medicare Part A and B operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS). Effective March 1, 1986, Blue Cross of Montana merged with Montana Physicians' Service, and the two companies became Blue Cross and Blue Shield of Montana. The two pension plans merged effective January 1, 1987.

### Segmentation Requirements

CMS incorporated segmentation requirements into Medicare contracts starting in fiscal year 1988. The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the segment. Furthermore, the contract requires Medicare segment assets to be updated for each year after the initial asset allocation in accordance with Cost Accounting Standards (CAS) 412 and 413. Finally, in claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation, CAS, and the Medicare contract.

### Regulations

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 whether Montana complied with the Medicare contracts' pension segmentation requirements while:

- identifying the Medicare segment's initial asset allocation, and
- updating the Medicare segment's assets from the initial asset allocation to January 1, 2004.

## **Scope**

We reviewed Montana's identification of its Medicare segment, computation of the initial assets allocated to the Medicare segment, and update of Medicare assets from January 1, 1987, to January 1, 2004.

Achieving our objective did not require us to review Montana's overall internal control structure. However, we did review controls relating to the identification of the Medicare segment and the update of the segment assets to ensure adherence to the Medicare contract, CAS 412, and CAS 413.

We performed fieldwork at Montana's office in Helena, Montana, during September 2006.

## **Methodology**

In performing our review, we used information provided by Montana's prior and current actuarial consulting firms. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed Montana's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s. In addition, the CMS Office of the Actuary staff members used the documents to calculate Medicare segment assets as of January 1, 2004. We reviewed their methodology and calculations.

We performed this review in conjunction with our audit of the pension costs Montana claimed for Medicare reimbursement (A-07-07-00227). The information obtained and reviewed during the audit also was used in performing this review.

Details of the Medicare segment's updated pension assets from January 1, 1987, to January 1, 2004, are presented in Appendix A.

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

## **FINDINGS AND RECOMMENDATIONS**

Montana did not comply with the Medicare contract's pension segmentation requirements when identifying the Medicare segment's initial asset allocation, and while updating Medicare segment assets from January 1, 1987, to January 1, 2004.

As a result, Montana overstated the January 1, 2004, Medicare segment pension assets by \$1,016,181. The overstatement occurred primarily because Montana omitted benefit payments in its rollup of segment assets. The accumulated overstatement of Medicare segment assets is shown in Table 1.

<b>Table 1: Summary of Asset Adjustments</b>	
Initial Asset Allocation	385,679
Contributions and Prepayment Transfers	(873,742)
Other Transactions	17,620
Earnings and Expenses	406,968
Benefit Payments	(872,091)
Net Transfers	(80,615)
<b>(Over)Understatement of Medicare Segment Assets</b>	<b>(1,016,181)</b>

## **MEDICARE CONTRACT AND COST ACCOUNTING STANDARDS**

### **Medicare Contract**

The Medicare contract identifies a Medicare segment as:

Any organizational component of the contractor, such as 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 contract also provides 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 is 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 after December 31, 1980, or the first day of the first pension plan year following the date such Medicare segment existed.

Furthermore, the Medicare contract states that: "...the pension assets allocated to each Medicare segment shall be adjusted in accordance with CAS 413.50(c)(7)."

### **Cost Accounting Standards**

The CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses. 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 method (WAV) of assets to total company WAV of assets.

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.

Furthermore, CAS 412.50(a)(4) provides that contributions in excess of the pension cost assigned to the period are recognized as prepayment credits and are 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.

## **INITIAL ASSET ALLOCATION**

Montana did not comply with the Medicare contract's pension segmentation requirements in identifying the Medicare segment's initial assets as of January 1, 1987.

As described in the Background, Blue Cross of Montana merged with Montana Physicians' Service effective March 1, 1986. Montana did not correctly identify January 1, 1987 (the first day of the first plan year following March 1, 1986) as the date of the initial asset allocation.

The Medicare contract required that the initial allocation of assets to the Medicare segment be determined by multiplying the total plan assets as of January 1, 1987, by a fraction (the "asset fraction"). The fraction's numerator is the actuarial liability for the Medicare segment, and the denominator is the actuarial liability for the total plan.

Montana's approach to calculating the asset fraction did not comply with the Medicare contract. We followed the contractual requirements and computed an asset fraction using the Medicare segment's actuarial liability in the asset fraction numerator. Our calculation identified the asset fraction as 12.8278%, which we applied to total company assets as of January 1, 1987. Use of the revised asset fraction increased the Medicare segment's assets as of January 1, 1987, by \$385,679.

## **COMPONENTS OF ASSET UPDATE**

Montana did not properly account for contributions and prepayment transfers, other transactions, earnings and expenses, benefit payments, and transfers while updating the segment's assets to January 1, 2004.

### **Contributions and Prepayment Transfers Overstated**

Montana's update methodology did not equitably assign pension contributions to the Medicare segment. As a result, Montana overstated contributions and prepayments by \$873,742. The overstatement occurred primarily because Montana's initial Medicare asset value and the asset values of subsequent years were incorrect. Additionally, Montana misidentified the Medicare segment by including non-Medicare employees in the Medicare segment from 1996 – 1999.

The audited contributions and prepayment transfers are based on the assignable pension costs as calculated by the CMS Office of the Actuary. Since prepayment credits are available at the beginning of the year, they are applied first to cover current year assignable pension costs, and

any remaining prepayment credits are updated with interest to the next measurement (valuation) date. Subsequent contributions are then allocated as needed to assigned pension costs as of the date of deposit.

The segment assets decreased by \$873,742 in the audited update, due to differences in assigned contributions and prepayment transfers. A comparison of Montana's and OIG's calculations of pension contributions and prepayment transfers is shown in Table 2.

<b>Year</b>	<b>OIG</b>	<b>Montana</b>	<b>Difference</b>
<b>1987</b>	66,527	63,286	3,241
<b>1988</b>	0	0	0
<b>1989</b>	34,875	85,186	(50,311)
<b>1990</b>	0	93,891	(93,891)
<b>1991</b>	38,968	101,823	(62,855)
<b>1992</b>	0	88,492	(88,492)
<b>1993</b>	129,164	122,509	6,655
<b>1994</b>	126,735	121,470	5,265
<b>1995</b>	98,862	88,883	9,979
<b>1996</b>	70,024	152,557	(82,533)
<b>1997</b>	71,270	179,041	(107,771)
<b>1998</b>	0	145,622	(145,622)
<b>1999</b>	64,283	180,183	(115,900)
<b>2000</b>	0	12,753	(12,753)
<b>2001</b>	0	118,705	(118,705)
<b>2002</b>	216,915	233,758	(16,843)
<b>2003</b>	329,115	332,321	(3,206)
<b>Total</b>	<b>1,246,738</b>	<b>2,120,480</b>	<b>(873,742)</b>

### **Other Transactions Understated**

We made a one-time adjustment to the Medicare segment's assets as of January 1, 1990. The adjustment of \$17,620 was necessary to reconcile actual pension costs reimbursed by Medicare during fiscal years 1987 – 1989 with Medicare segment assets.

### **Earnings and Expenses Understated**

Montana understated investment earnings, less administrative expenses, by \$406,968 for the Medicare segment. The understatement was a result of Montana's incorrect methodology in allocating investment income and expenses to the Medicare segment after the effective date of the revised CAS (plan year 1996). In our audited update, we allocated earnings and expenses based on the applicable CAS requirement.

### Benefit Payments Understated

Montana understated benefit payments by \$872,091 because it omitted Medicare benefit payments made during 2003, and because it incorrectly calculated Medicare's share of annuity payments in three different years. This understatement of benefit payments resulted in an overstatement of the Medicare segment assets.

A comparison of Montana's and OIG's calculations of benefit payments is shown in Table 3.

<b>Year</b>	<b>OIG</b>	<b>Montana</b>	<b>Difference</b>
<b>1987</b>	0	0	0
<b>1988</b>	119,030	122,975	(3,945)
<b>1989</b>	2,009	2,009	0
<b>1990</b>	4,347	4,347	0
<b>1991</b>	619	2,478	(1,859)
<b>1992</b>	0	0	0
<b>1993</b>	49,200	57,024	(7,824)
<b>1994</b>	473,800	473,800	0
<b>1995</b>	0	0	0
<b>1996</b>	0	0	0
<b>1997</b>	22,859	22,859	0
<b>1998</b>	1,441	1,441	0
<b>1999</b>	0	3,951	(3,951)
<b>2000</b>	6,672	6,672	0
<b>2001</b>	145,284	145,284	0
<b>2002</b>	0	0	0
<b>2003</b>	889,670	0	889,670
<b>Total</b>	<b>1,714,931</b>	<b>842,840</b>	<b>872,091</b>

### Net Transfers Overstated

Montana made adjustments for participant transfers in its update of Medicare segment assets from January 1, 1987, to January 1, 2004. However, we determined that its adjustments were incorrect. As a result, Montana's Medicare segment assets were overstated by \$80,615.

Following Montana's methodology, our transfer adjustments considered each participant's actuarial liability and, where appropriate, the funding level of the segment from which the participant transferred. For transfers occurring prior to the 1996 plan year, asset transfers reflected the transferred liabilities multiplied by 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 was greater than one, we transferred assets equal to the participant's liability. For plan years starting with 1996, asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with CAS.

A difference existed in transfers as a result of different initial assets (as of January 1, 1987) and different asset values calculated in subsequent years for 1988 – 1996. Consequently, different funding level percentages were calculated and applied to liability transfers, thereby resulting in different asset transfers.

A comparison of Montana’s and OIG calculations of net asset transfers from the Medicare segment is shown in Table 4.

<b>Year</b>	<b>OIG</b>	<b>Montana</b>	<b>Difference</b>
<b>1987</b>	(6,935)	(294)	(6,641)
<b>1988</b>	(73,826)	(27,763)	(46,063)
<b>1989</b>	(5,723)	(2,602)	(3,121)
<b>1990</b>	(13,126)	(6,390)	(6,736)
<b>1991</b>	(30,498)	(24,667)	(5,831)
<b>1992</b>	9,619	12,128	(2,509)
<b>1993</b>	(148,567)	(116,620)	(31,947)
<b>1994</b>	41,054	56,630	(15,576)
<b>1995</b>	(12,396)	124,202	(136,598)
<b>1996</b>	(18,450)	(22,092)	3,642
<b>1997</b>	(35,421)	(35,421)	0
<b>1998</b>	(32,349)	(41,047)	8,698
<b>1999</b>	(13,472)	(167,962)	154,490
<b>2000</b>	(24,757)	(24,757)	0
<b>2001</b>	(1,827)	6,691	(8,518)
<b>2002</b>	(89,097)	(98,263)	9,166
<b>2003</b>	(27,732)	(34,661)	6,929
<b>Total</b>	<b>(483,503)</b>	<b>(402,888)</b>	<b>(80,615)</b>

## **OVERSTATEMENT OF MEDICARE SEGMENT ASSETS**

Montana did not ensure that the Medicare segment’s assets were updated in accordance with the Medicare contract. As of January 1, 2004, Montana overstated Medicare segment pension assets by \$1,016,181.

## **RECOMMENDATIONS**

We recommend that Montana:

- decrease Medicare segment pension assets by \$1,016,181 as of January 1, 2004, and
- implement controls to ensure that the Medicare segment’s assets are updated in accordance with the Medicare contracts.

## **AUDITEE'S COMMENTS**

In written comments on our draft report, Montana partially concurred with our recommendation to decrease Medicare segment pension assets by \$1,016,181. While Montana stated that its actuaries had already corrected the omission of the 2003 Medicare segment benefit payments, it questioned our January 1, 1987 initial asset allocation date. Specifically, Montana stated that it "... does not fully understand the initial valuation date used by the OIG in determining the Medicare segment's initial assets." Montana also stated, "... we believe the pension valuation documentation for 1986 is sufficient to allow an initial asset valuation as of that date. . . ."

In addition, Montana agreed to update future Medicare segment assets in accordance with the Medicare contracts. Montana's response is included in its entirety as Appendix B.

## **OFFICE OF INSPECTOR GENERAL'S RESPONSE**

After reviewing Montana's comments, we continue to believe that Montana should decrease Medicare segment pension assets by \$1,016,181.

The Medicare contract requires that the segment's initial asset allocation occur as of the later of either the first day of the first pension plan year following December 31, 1985, or the first day of the first pension plan year following the date the 1988 Medicare segment first existed. Furthermore, the asset allocation must use an asset fraction computed as of the later of either the first day of the first plan year after December 31, 1980, or the first day of the first pension plan year following the date the 1988 Medicare segment first existed. Given Montana's merger history, Montana's 1988 Medicare segment first existed after March 1, 1986. Therefore, Montana's contract requires an asset fraction and initial asset allocation as of January 1, 1987. Our recommendations reflect that date as the initial valuation date, and we continue to believe that our calculations (which use January 1, 1987 as the Medicare segment's initial asset allocation date) and recommendations are correct.

## **APPENDIXES**

**Blue Cross Blue Shield of Montana**  
**Statement of Medicare Pension Assets**  
**For the Period**  
**January 1, 1987, to January 1, 2004**

Description	Total Company	Other Segment	Medicare Segment
Assets January 1, 1987	<u>1/</u> \$6,499,850	5,666,062	\$833,788
Prepayment Transfer	0	0	0
Contributions	<u>2/</u> 355,710	289,183	66,527
Other Transactions	0	0	0
Earnings	<u>3/</u> 304,378	265,333	39,045
Benefit Payments	<u>4/</u> (475,127)	(475,127)	0
Expenses	<u>5/</u> (38,731)	(33,763)	(4,968)
Transfers	<u>6/</u> 0	6,935	(6,935)
Assets January 1, 1988	6,646,080	5,718,623	927,457
Prepayment Transfer	0	0	0
Contributions	0	0	0
Other Transactions	0	0	0
Earnings	856,559	737,027	119,532
Benefit Payments	(1,009,268)	(890,238)	(119,030)
Expenses	(44,109)	(37,954)	(6,155)
Transfers	0	73,826	(73,826)
Assets January 1, 1989	6,449,262	5,601,284	847,978
Prepayment Transfer	0	(362)	362
Contributions	545,498	510,985	34,513
Other Transactions	<u>7/</u> 0	(17,620)	17,620
Earnings	1,457,872	1,266,103	191,769
Benefit Payments	(257,579)	(255,570)	(2,009)
Expenses	(47,390)	(41,156)	(6,234)
Transfers	0	5,723	(5,723)
Assets January 1, 1990	8,147,663	7,069,387	1,078,276
Prepayment Transfer	0	0	0
Contributions	229,254	229,254	0
Other Transactions	0	0	0
Earnings	(206,056)	(178,786)	(27,270)
Benefit Payments	(250,159)	(245,812)	(4,347)
Expenses	(52,895)	(45,895)	(7,000)
Transfers	0	13,126	(13,126)
Assets January 1, 1991	\$7,867,807	\$6,841,274	\$1,026,533

**Blue Cross Blue Shield of Montana**  
**Statement of Medicare Pension Assets**  
**For the Period**  
**January 1, 1987, to January 1, 2004**

Description	Total Company	Other Segment	Medicare Segment
<b>Assets January 1, 1991</b>	<b>\$7,867,807</b>	<b>\$6,841,274</b>	<b>\$1,026,533</b>
Prepayment Transfer	0	0	0
Contributions	567,835	528,867	38,968
Other Transactions	0	0	0
Earnings	1,729,410	1,503,769	225,641
Benefit Payments	(277,990)	(277,371)	(619)
Expenses	(47,675)	(41,455)	(6,220)
Transfers	0	30,498	(30,498)
<b>Assets January 1, 1992</b>	<b>9,839,387</b>	<b>8,585,582</b>	<b>1,253,805</b>
Prepayment Transfer	0	0	0
Contributions	436,589	436,589	0
Other Transactions	0	0	0
Earnings	387,010	337,694	49,316
Benefit Payments	(258,614)	(258,614)	0
Expenses	(49,941)	(43,577)	(6,364)
Transfers	0	(9,619)	9,619
<b>Assets January 1, 1993</b>	<b>10,354,431</b>	<b>9,048,055</b>	<b>1,306,376</b>
Prepayment Transfer	0	0	0
Contributions	858,618	729,454	129,164
Other Transactions	0	0	0
Earnings	1,056,670	923,354	133,316
Benefit Payments	(295,724)	(246,524)	(49,200)
Expenses	(73,516)	(64,241)	(9,275)
Transfers	0	148,567	(148,567)
<b>Assets January 1, 1994</b>	<b>11,900,479</b>	<b>10,538,665</b>	<b>1,361,814</b>
Prepayment Transfer	0	0	0
Contributions	1,141,662	1,014,927	126,735
Other Transactions	0	0	0
Earnings	(39,490)	(34,971)	(4,519)
Benefit Payments	(5,577,442)	(5,103,642)	(473,800)
Expenses	(58,585)	(51,881)	(6,704)
Transfers	0	(41,054)	41,054
<b>Assets January 1, 1995</b>	<b>\$7,366,624</b>	<b>\$6,322,044</b>	<b>\$1,044,580</b>

**Blue Cross Blue Shield of Montana**  
**Statement of Medicare Pension Assets**  
**For the Period**  
**January 1, 1987, to January 1, 2004**

Description	Total Company	Other Segment	Medicare Segment
<b>Assets January 1, 1995</b>	<b>\$7,366,624</b>	<b>\$6,322,044</b>	<b>\$1,044,580</b>
Prepayment Transfer	8/ 0	(17,323)	17,323
Contributions	1,210,825	1,129,286	81,539
Other Transactions	0	0	0
Earnings	1,994,658	1,707,127	287,531
Benefit Payments	(281,983)	(281,983)	0
Expenses	(40,897)	(35,002)	(5,895)
Transfers	0	12,396	(12,396)
<b>Assets January 1, 1996</b>	<b>10,249,227</b>	<b>8,836,545</b>	<b>1,412,682</b>
Prepayment Transfer	0	(27,598)	27,598
Contributions	1,420,538	1,378,112	42,426
Other Transactions	0	0	0
Earnings	1,691,855	1,456,643	235,212
Benefit Payments	(341,068)	(341,068)	0
Expenses	(59,082)	(50,868)	(8,214)
Transfers	0	18,450	(18,450)
<b>Assets January 1, 1997</b>	<b>12,961,470</b>	<b>11,270,216</b>	<b>1,691,254</b>
Prepayment Transfer	0	(48,291)	48,291
Contributions	1,296,737	1,273,758	22,979
Other Transactions	0	0	0
Earnings	2,668,632	2,314,955	353,677
Benefit Payments	(402,653)	(379,794)	(22,859)
Expenses	(75,071)	(65,122)	(9,949)
Transfers	0	35,421	(35,421)
<b>Assets January 1, 1998</b>	<b>16,449,115</b>	<b>14,401,143</b>	<b>2,047,972</b>
Prepayment Transfer	0	0	0
Contributions	567,475	567,475	0
Other Transactions	0	0	0
Earnings	2,652,295	2,321,865	330,430
Benefit Payments	(388,893)	(387,452)	(1,441)
Expenses	(98,663)	(86,371)	(12,292)
Transfers	0	32,349	(32,349)
<b>Assets January 1, 1999</b>	<b>\$19,181,329</b>	<b>\$16,849,009</b>	<b>\$2,332,320</b>

**Blue Cross Blue Shield of Montana**  
**Statement of Medicare Pension Assets**  
**For the Period**  
**January 1, 1987, to January 1, 2004**

Description	Total Company	Other Segment	Medicare Segment
<b>Assets January 1, 1999</b>	<b>\$19,181,329</b>	<b>\$16,849,009</b>	<b>\$2,332,320</b>
Prepayment Transfer	0	(33,558)	33,558
Contributions	1,030,328	999,603	30,725
Other Transactions	0	0	0
Earnings	3,142,397	2,746,530	395,867
Benefit Payments	(819,988)	(819,988)	0
Expenses	(96,361)	(84,222)	(12,139)
Transfers	0	13,472	(13,472)
<b>Assets January 1, 2000</b>	<b>22,437,705</b>	<b>19,670,846</b>	<b>2,766,859</b>
Prepayment Transfer	0	0	0
Contributions	488,427	488,427	0
Other Transactions	0	0	0
Earnings	(864,191)	(751,176)	(113,015)
Benefit Payments	(2,637,504)	(2,630,832)	(6,672)
Expenses	(138,390)	(120,292)	(18,098)
Transfers	0	24,757	(24,757)
<b>Assets January 1, 2001</b>	<b>19,286,047</b>	<b>16,681,730</b>	<b>2,604,317</b>
Prepayment Transfer	0	0	0
Contributions	3,950,000	3,950,000	0
Other Transactions	0	0	0
Earnings	(983,633)	(852,597)	(131,036)
Benefit Payments	(685,424)	(540,140)	(145,284)
Expenses	(115,861)	(100,426)	(15,435)
Transfers	0	1,827	(1,827)
<b>Assets January 1, 2002</b>	<b>21,451,129</b>	<b>19,140,394</b>	<b>2,310,735</b>
Prepayment Transfer	0	(216,915)	216,915
Contributions	6,056,000	6,056,000	0
Other Transactions	0	0	0
Earnings	(1,676,940)	(1,471,435)	(205,505)
Benefit Payments	(1,650,594)	(1,650,594)	0
Expenses	(48,213)	(42,305)	(5,908)
Transfers	0	89,097	(89,097)
<b>Assets January 1, 2003</b>	<b>\$24,131,382</b>	<b>\$21,904,242</b>	<b>\$2,227,140</b>

**Blue Cross Blue Shield of Montana**  
**Statement of Medicare Pension Assets**  
**For the Period**  
**January 1, 1987, to January 1, 2004**

Description	Total Company	Other Segment	Medicare Segment
Assets January 1, 2003	\$24,131,382	\$21,904,242	\$2,227,140
Prepayment Transfer	0	(329,115)	329,115
Contributions	6,000,000	6,000,000	0
Other Transactions	0	0	0
Earnings	4,326,333	3,924,268	402,065
Benefit Payments	(2,823,780)	(1,934,110)	(889,670)
Expenses	(122,796)	(111,384)	(11,412)
Transfers	0	27,732	(27,732)
Assets January 1, 2004	\$31,511,139	\$29,481,633	\$2,029,506
Per Montana	<u>9/</u> \$31,511,139	\$28,465,452	\$3,045,687
Asset Variance	<u>10/</u> \$0	\$1,016,181	(\$1,016,181)

**FOOTNOTES**

- 1/ As explained in the Findings and Recommendations, Montana did not comply with the Medicare contract's pension segmentation requirements when identifying the Medicare segment's initial asset allocation. 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 Form 5500s. 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 and documents prepared by Montana's consulting actuarial firm. We allocated investment earnings based on the market value of Medicare assets at the beginning of the plan year after adjustment for 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.
  
- 4/ We reviewed and accepted Montana's benefit payments to Medicare segment retirees except as explained in the Components of Asset Update section.
  
- 5/ We allocated administrative expenses to the Medicare segment in proportion to investment income.

**Blue Cross Blue Shield of Montana**  
**Statement of Medicare Pension Assets**  
**For the Period**  
**January 1, 1987, to January 1, 2004**

**APPENDIX A**

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- 6/ Montana made adjustments for participant transfers between segments. We accepted Montana's calculations except as explained in the Components of Asset Update section.
- 7/ The Other Transactions involved a one-time adjustment necessary to reconcile actual pension costs reimbursed by Medicare during Fiscal Years 1987 - 1989 with the Medicare segment assets.
- 8/ 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.
- 9/ We obtained total asset amounts as of January 1, 2004, from documents prepared by Montana's actuarial consulting firm.
- 10/ The asset variance represents the difference between our calculation of Medicare segment assets and Montana's market value of assets.



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March 16, 2007

Patrick J. Cogley  
Regional Inspector General for Audit Services  
Office of Inspector General  
Offices of Audit Services, Region VII  
601 E 12<sup>th</sup> St, Rm 284A  
Kansas City MO 64106

Re: Report Number A-07-07-00226

Dear Mr. Cogley:

Blue Cross Blue Shield of Montana (BCBSMT) is in receipt of the draft copies of the OIG report entitled "Review of Medicare Contractor's Pension Segmentation Requirements at BCBSMT for January 1, 1987 to January 1, 2004."

In this report, the OIG recommends the BCBSMT decrease Medicare pension segment pension assets by \$1,016,181 as of January 1, 2004. The OIG also recommends that BCBSMT implement controls to ensure that the Medicare segment's assets are updated in accordance with the Medicare contracts.

BCBSMT partially concurs with these recommendations and has implemented the following corrective action:

1. As described in the draft report, the 2003 pension valuation did not include \$872,091 in benefit payments that were made that year. Fortunately, Chicago Consulting Actuarial Strategies, (CCA), discovered this mistake while preparing the 2004 valuation and made the correction at that time. As such, the bulk of the \$1M+ adjustment to assets has been made. We will continue to work with our actuaries to evaluate the other events contributing to the remaining recommended asset reduction.
2. BCBSMT's Human Resources department, which annually provides participant data to CCA for the pension valuation, has already implemented checkpoints for review of the data prior to providing it to CCA. These checkpoints were established in February 2007 and so will be in effect for the 2006 pension valuation. In addition, our Finance department will work with a pension consultant to establish checkpoints to review once the pension valuation reports are received from CCA.

BCBSMT does not fully understand the initial valuation date used by the OIG in determining the Medicare segment's initial assets. As stated in the draft report, pension assets of the Medicare segment should have been established "as of the first pension plan

year after December 31, 1985, in which the salary criterion was met.” Since BCBSMT values its pension plan on a calendar year basis, we don’t understand why the initial segment identification was not January 1, 1986 rather than January 1, 1987 as used by the OIG and whether the use of a January 1, 1986 initial asset valuation date would have significantly altered the resulting asset allocation. Prior to March 1986, Blue Cross of Montana and Blue Shield of Montana were separate companies. Blue Cross of Montana held the Medicare Part A subcontract, and Blue Shield of Montana held the Medicare Part B contract. In March 1986, the two companies merged, and it appears that the OIG used this event to mark the January 1, 1987 date of the initial asset allocation. Although Blue Cross of Montana and Blue Shield of Montana were two separate plans as of January 1, 1986, we believe the pension valuation documentation for 1986 is sufficient to allow an initial asset valuation as of that date if it would materially change the resulting asset fraction. We, along with CCA, are open to further discussion with the OIG about this portion of the report in order to better comprehend the use of the January 1, 1987 date.

We appreciate the opportunity to provide input on the draft report. If you have any questions about our response, please contact Erin Frisbey, 406-444-8983.

Sincerely,



Eric Schindler  
BCBSMT Vice President and Chief Financial Officer