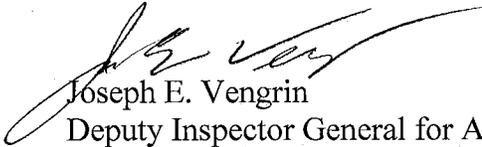




FEB 20 2009

**TO:** Charlene Frizzera  
Acting Administrator  
Centers for Medicare & Medicaid Services

**FROM:**   
Joseph E. Vengrin  
Deputy Inspector General for Audit Services

**SUBJECT:** Review of the Qualified Pension Plan at CareFirst of Maryland, Incorporated, a Terminated Medicare Contractor, for the Period January 1, 2002, to December 31, 2005 (A-07-07-00243)

Attached is an advance copy of our final report on the qualified pension plan at CareFirst of Maryland, Incorporated (CareFirst), a terminated Medicare contractor. We will issue this report to CareFirst within 5 business days.

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

- updating Medicare segment assets from January 1, 2002, to December 31, 2005; and
- determining Medicare's share of the Medicare segment excess pension assets as of the termination of CareFirst's Medicare contracts.

CareFirst did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements. Specifically, when updating Medicare segment assets from January 1, 2002, to December 31, 2005, CareFirst overstated investment earnings, less administrative expenses, for the Medicare segment. As a result, CareFirst overstated the Medicare segment assets by \$10,793.

In addition, CareFirst did not fully comply with Federal requirements in its calculation of Medicare's share of the Medicare segment excess pension assets associated with the termination of the Medicare contracts. We identified \$4,271,992 as Medicare's share; however, CareFirst identified \$3,760,472 as Medicare's share. Thus, CareFirst understated Medicare's share by \$511,520.

We recommend that CareFirst:

- decrease Medicare segment pension assets as of December 31, 2005, by \$10,793;
- increase Medicare's share of the excess Medicare segment pension assets as of December 31, 2005, by \$511,520; and
- refund to the Federal Government \$4,271,992, which we calculated to be Medicare's share of the Medicare segment excess pension assets as of the termination of the Medicare contracts.

In written comments on our draft report, CareFirst concurred with our first recommendation but disagreed with our second and third recommendations. CareFirst's comments offered substantively the same arguments that CareFirst officials raised, and that we considered, during our review. Accordingly, and after reviewing CareFirst's written comments, we continue to support all of our findings and recommendations.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through e-mail at [George.Reeb@oig.hhs.gov](mailto:George.Reeb@oig.hhs.gov) or Patrick J. Cogley, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591 or through e-mail at [Patrick.Cogley@oig.hhs.gov](mailto:Patrick.Cogley@oig.hhs.gov). Please refer to report number A-07-07-00243.

Attachment



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Offices of Audit Services

FEB 27 2009

Region VII  
601 East 12th Street  
Room 204A  
Kansas City, Missouri 64106

Report Number: A-07-07-00243

Mr. Emery Hill  
Manager, External Audit Coordination  
CareFirst of Maryland, Incorporated  
10455 Mill Run Circle  
Owings Mills, Maryland 21117

Dear Mr. Hill:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of the Qualified Pension Plan at CareFirst of Maryland, Incorporated, a Terminated Medicare Contractor, for the Period January 1, 2002, to December 31, 2005." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

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

Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, OIG reports generally are made available to the public to the extent that information in the report is not subject to exemptions in the Act. Accordingly, this report will be posted on the Internet at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through e-mail at [Jenenne.Tambke@oig.hhs.gov](mailto:Jenenne.Tambke@oig.hhs.gov). Please refer to report number A-07-07-00243 in all correspondence.

Sincerely,

Patrick J. Cogley  
Regional Inspector General  
for Audit Services

Enclosure

**Direct Reply to HHS Action Official:**

Ms. Nanette Foster Reilly  
Consortium Administrator  
Consortium for Financial Management & Fee for Service Operations  
Centers for Medicare & Medicaid Services  
601 East 12th Street, Room 235  
Kansas City, Missouri 64106

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF THE QUALIFIED  
PENSION PLAN AT CAREFIRST  
OF MARYLAND, INCORPORATED,  
A TERMINATED MEDICARE  
CONTRACTOR, FOR THE PERIOD  
JANUARY 1, 2002, TO  
DECEMBER 31, 2005**



Daniel R. Levinson  
Inspector General

February 2009  
A-07-07-00243

# ***Office of Inspector General***

<http://oig.hhs.gov>

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The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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The Office of Audit Services (OAS) provides auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

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## **EXECUTIVE SUMMARY**

### **BACKGROUND**

CareFirst of Maryland, Incorporated (CareFirst), administered Medicare Part A and Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) beginning July 1, 1966. On December 31, 1994, the Part B contractual relationship was terminated, and on September 30, 2005, the Part A contractual relationship was terminated. The effective closing date for the Medicare segment was December 31, 2005.

#### **Pension Plan**

CareFirst sponsors a defined-benefit pension plan, which is a deferred compensation plan in which an employer makes actuarially determined contributions to fund an employee's retirement benefit as defined by the plan's terms.

Since its inception, Medicare has paid a portion of contractors' contributions to their pension plans. These contributions are allowable Medicare costs subject to the criteria set forth in the Medicare contracts, Federal Acquisition Regulation, and Cost Accounting Standards (CAS). Furthermore, the Medicare contracts specifically prohibit any profit (gain) from Medicare activities. Therefore, contractors must credit to the Medicare program those pension gains (excess pension assets) that occur when a Medicare segment terminates.

#### **Pension Segmentation**

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

Upon the termination of its Medicare contracts, CareFirst identified Medicare's share of the Medicare segment excess pension assets to be \$3,760,472. However, CareFirst has not refunded any of this amount, opting to wait until the results of our audit are finalized.

### **OBJECTIVE**

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

- updating Medicare segment assets from January 1, 2002, to December 31, 2005; and
- determining Medicare's share of the Medicare segment excess pension assets as of the termination of CareFirst's Medicare contracts.

## **SUMMARY OF FINDINGS**

CareFirst did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements. Specifically, when updating Medicare segment assets from January 1, 2002, to December 31, 2005, CareFirst overstated investment earnings, less administrative expenses, for the Medicare segment. As a result, CareFirst overstated the Medicare segment assets by \$10,793.

In addition, CareFirst did not fully comply with Federal requirements in its calculation of Medicare's share of the Medicare segment excess pension assets associated with the termination of the Medicare contracts. We identified \$4,271,992 as Medicare's share; however, CareFirst identified \$3,760,472 as Medicare's share. Thus, CareFirst understated Medicare's share by \$511,520.

## **RECOMMENDATIONS**

We recommend that CareFirst:

- decrease Medicare segment pension assets as of December 31, 2005, by \$10,793;
- increase Medicare's share of the excess Medicare segment pension assets as of December 31, 2005, by \$511,520; and
- refund to the Federal Government \$4,271,992, which we calculated to be Medicare's share of the Medicare segment excess pension assets as of the termination of the Medicare contracts.

## **AUDITEE COMMENTS**

In written comments on our draft report, CareFirst concurred with our first recommendation but disagreed with our second and third recommendations. CareFirst stated that our calculations did not take into account that the Federal Government did not fully participate in the funding of the Medicare pension segment assets. CareFirst provided additional information about its "unique" situation, information which ". . . makes the application of a strict pension cost calculation inaccurate and is not the intent of CAS 413." CareFirst's comments are included in their entirety as Appendix C.

## **OFFICE OF INSPECTOR GENERAL RESPONSE**

After reviewing CareFirst's written comments, we continue to support all of our findings and recommendations, including our recommendation that CareFirst refund to the Federal Government \$4,271,992, which we calculated to be Medicare's share of the Medicare segment excess pension assets as of the termination of the Medicare contracts. Notwithstanding CareFirst's stated belief that the Federal Government had not fully participated in the funding of the Medicare segment assets, CareFirst's computations did not fully comply with the pension-cost-only methodology specified by CAS 413.

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## **Glossary of Abbreviations and Acronyms**

CareFirst	CareFirst of Maryland, Incorporated
CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
FAR	Federal Acquisition Regulation
WAV	weighted average value

## **INTRODUCTION**

### **BACKGROUND**

CareFirst of Maryland, Incorporated (CareFirst), administered Medicare Part A and Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) beginning July 1, 1966. On December 31, 1994, the Part B contractual relationship was terminated, and on September 30, 2005, the Part A contractual relationship was terminated. The effective closing date for the Medicare segment was December 31, 2005.

### **Pension Plan**

CareFirst sponsors a defined benefit pension plan, which is a deferred compensation plan in which an employer makes actuarially determined contributions to fund an employee's benefit as defined by the plan's terms. Once an employee satisfies the plan's age and service requirements and retires, he or she is eligible to receive a monthly payment from the plan. The plan accumulates assets from employer contributions and net investment earnings to fund the actuarial liability for both earned and projected future benefits. To the extent that assets accumulate from better-than-expected investment earnings, the amount of required annual employer contributions decreases and may even be eliminated for some years.

Since its inception, Medicare has paid a portion of contractors' contributions to their pension plans. These contributions are allowable Medicare costs subject to the criteria set forth in the Medicare contracts, Federal Acquisition Regulation (FAR), and Cost Accounting Standards (CAS). Furthermore, the Medicare contracts specifically prohibit any profit (gain) from Medicare activities. Therefore, contractors must credit to the Medicare program those pension gains (excess pension assets) that occur when a Medicare segment terminates.

### **Federal Requirements**

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

CAS 413 addresses the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods. CAS 413 also addresses the determination of segment assets and liabilities in the event of contract terminations, segment closings, or pension plan terminations.

FAR part 31 addresses the allowability of pension costs and the recovery of gains, rebates, and other forms of credits for Federal contractors.

### **Pension Segmentation**

CMS incorporated CAS 412 and 413 into the Medicare contracts effective October 1, 1980. Starting in fiscal year 1988, CMS incorporated segmentation requirements into Medicare

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

Upon the termination of its Medicare contracts, CareFirst identified Medicare's share of the Medicare segment excess pension assets to be \$3,760,472. However, CareFirst has not refunded any of this amount, opting to wait until the results of our audit are finalized.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

### **Objective**

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

- updating Medicare segment assets from January 1, 2002, to December 31, 2005; and
- determining Medicare's share of the Medicare segment excess pension assets as of the termination of CareFirst's Medicare contracts.

### **Scope**

We reviewed CareFirst's identification of its Medicare segment; update of Medicare segment assets from January 1, 2002, to the December 31, 2005, determination of final segment liabilities; and development of Medicare's share of the Medicare segment's excess assets as of December 31, 2005. Although CareFirst's Medicare contracts were terminated on September 30, 2005, we agreed with CareFirst's request to use December 31, 2005, as the closing date for the Medicare pension segment.

Achieving our objective did not require us to review CareFirst's overall internal control structure. We reviewed controls relating to the identification of the Medicare segment, the update of the segment's assets, the determination of the final segment liabilities, and the development of Medicare's share of the segment's excess pension assets.

We performed fieldwork at CareFirst in Baltimore, Maryland, during October 2005 and May 2007.

### **Methodology**

To accomplish our objective:

- We reviewed the applicable portions of the FAR, CAS, and the Medicare contracts.

- We reviewed the annual actuarial valuation reports prepared by CareFirst's actuarial consulting firm, which included the pension plan's assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We used this information to calculate the Medicare segment assets.
- We obtained the pension plan documents and Department of Labor/Internal Revenue Service Form 5500s used in calculating the Medicare segment assets.
- We interviewed CareFirst staff responsible for identifying the Medicare segment to determine whether the segment was properly identified in accordance with the Medicare contracts.
- We reviewed CareFirst's accounting records to verify the segment identification and benefit payments made to the Medicare segment.
- We provided the CMS Office of the Actuary with the actuarial information necessary for it to calculate the Medicare segment assets and the Medicare segment excess pension assets as of December 31, 2005.
- We reviewed the CMS actuaries' methodology and calculations.

We performed this review in conjunction with our audit of CareFirst's pension costs claimed for Medicare reimbursement (A-07-07-00244) and used the information obtained during that audit in this review. In addition, we used information obtained during our prior pension segmentation audits (A-07-93-00692 and A-07-02-03033) in this review.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

## **FINDINGS AND RECOMMENDATIONS**

CareFirst did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements. Specifically, when updating Medicare segment assets from January 1, 2002, to December 31, 2005, CareFirst overstated investment earnings, less administrative expenses, for the Medicare segment. As a result, CareFirst overstated the Medicare segment assets by \$10,793. Appendix A presents details on the Medicare segment's pension assets from January 1, 2002, to December 31, 2005, as determined during our audit.

In addition, CareFirst did not fully comply with Federal requirements in its calculation of Medicare's share of the Medicare segment excess pension assets associated with the termination of the Medicare contracts. We identified \$4,271,992 as Medicare's share; however, CareFirst

identified \$3,760,472 as Medicare's share.<sup>1</sup> Thus, CareFirst understated Medicare's share by \$511,520.

## **UPDATE OF MEDICARE SEGMENT PENSION ASSETS**

### **Federal Requirements**

The Medicare contracts state that “. . . the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7).” CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses. For plan years beginning on or before March 30, 1995, the CAS requires investment income and expenses to be allocated among segments in proportion to the beginning-of-year asset value. For plan years beginning after March 30, 1995, the CAS requires investment income and expenses to be allocated among segments based on the ratio of the segment's weighted average value (WAV) of assets to total company WAV of assets.

### **Earnings and Expenses Overstated**

CareFirst overstated investment earnings, less administrative expenses, by \$10,793 for the Medicare segment. CareFirst did not use the WAV of assets to allocate earnings as required by CAS 413.50(c)(7). Instead, CareFirst allocated investment earnings and administrative expenses to the Medicare segment based on a ratio of beginning-of-year segment assets to total company assets. Because of this error, CareFirst's allocation basis differed from that required by the CAS and led to incorrect allocation amounts. In our audited update, we allocated earnings and expenses based on the applicable CAS requirements.

## **MEDICARE SEGMENT EXCESS PENSION ASSETS**

### **Federal Requirements**

#### *Medicare Contracts*

The Medicare contracts specifically prohibit any profit (gain) from Medicare activities. Pension gains that occur when a segment closes (i.e., contract terminations) must be credited to the Medicare program, as required by the FAR. In the event of a contract termination, the Medicare contracts require contractors to follow the segment closing provision of the CAS.

#### *Federal Acquisition Regulation*

The FAR addresses dispositions of gains in situations such as segment closings. When excess or surplus assets revert to a contractor because of a termination of a pension plan or when such assets are constructively received by the contractor for any reason, the contractor must make a refund or give credit to the Government for its equitable share (FAR 31.205-6(j)(3)).

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<sup>1</sup>As stated earlier, CareFirst has not refunded any of these excess assets.

### *Cost Accounting Standards*

During 1980, CMS renegotiated the Medicare contracts and expressly incorporated CAS 412 and 413 into the contracts beginning October 1, 1980.

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

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

(i) The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs . . . .

(ii) . . . The market value of the assets shall be reduced by the accumulated value of prepayment credits, if any. Conversely, the market value of assets shall be increased by the current value of any unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2).

(iii) The calculation of the difference between the market value of the assets and the actuarial accrued liability shall be made as of the date of the event (e.g., contract termination, plan amendment, plant closure) that caused the closing of the segment, pension plan termination, or curtailment of benefits. If such a date is not readily determinable, or if its use can result in an inequitable calculation, the contracting parties shall agree on an appropriate date.

### **Excess Medicare Segment Pension Assets as of December 31, 2005**

CareFirst identified \$4,282,785 in excess Medicare segment pension assets as of December 31, 2005. However, we calculated the excess pension assets to be \$4,271,992 as of that date. Therefore, CareFirst overstated the excess pension assets by \$10,793. The overstatement occurred because, as previously discussed, CareFirst did not comply with the CAS in updating the Medicare segment pension assets to December 31, 2005. (CareFirst correctly identified the segment's accrued liabilities and accumulated unfunded pension costs.) Table 1 on the next page summarizes the differences between CareFirst's and our calculations.

<b>Table 1: Adjustments to Excess Medicare Segment Pension Assets</b>			
	<b>Per Audit</b>	<b>Per CareFirst</b>	<b>Difference</b>
Medicare segment assets as of December 31, 2005	\$9,975,448	\$9,986,241	(\$10,793)
Accrued liabilities of segment participants	(5,811,342)	(5,811,342)	0
Accumulated unfunded pension costs	107,886	107,886	0
Medicare segment excess pension assets	4,271,992	4,282,785	
<b>Overstatement</b>			<b>(\$10,793)</b>

## Medicare's Share of Excess Pension Assets as of December 31, 2005

### *Federal Requirements*

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

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

### *CareFirst's Approach*

CareFirst calculated Medicare's share of the segment's excess assets by developing a final aggregate Medicare percentage using a two-step approach that did not fully comply with the pension-cost-only methodology specified by CAS 413. The first step of the approach was based on CareFirst's belief that the Government had not fully participated in the initial funding of the 1986 Medicare segment assets.<sup>2</sup> Accordingly, CareFirst calculated what it believed to be Medicare's portion of the 1986 Medicare segment assets. As a second step, CareFirst used a weighted average approach and incorporated the Medicare segment's reimbursed pension costs<sup>3</sup> to develop a final Medicare percentage. Although CareFirst's approach incorporated the CAS 413 methodology in part, the approach also considered asset values, which included factors other than pension costs. Therefore, CareFirst's approach did not comply with the pension-cost-only method specified by CAS 413.

<sup>2</sup>The development of the 1986 initial Medicare segment assets was addressed in a previous audit (A-07-93-00692). The purpose of that audit did not include developing Medicare's share of 1986 Medicare segment assets.

<sup>3</sup>This second step of CareFirst's computations considered the 4 years (fiscal years 1988 through 1991) in which the Medicare segment's pension costs were greater than \$0.

*Results per Audit*

CareFirst computed \$3,760,472 as Medicare’s share of the Medicare segment excess pension assets as of December 31, 2005; however, we determined that Medicare’s share was \$4,271,992. Therefore, CareFirst understated Medicare’s share by \$511,520.

In accordance with CAS 413.50(c)(12)(vi), we calculated the aggregate Medicare percentage using the Medicare segment pension costs developed during both the previous and the current pension audits. Appendix B shows our calculation of the Medicare segment’s aggregate Medicare percentage; Table 2 shows our calculation of Medicare’s share of the excess assets.

	<u>Excess Medicare Segment Assets (A)</u>	<u>Aggregate Medicare Percentage (B)</u>	<u>Excess Assets Attributable to Medicare (A x B)</u>
Per audit	\$4,271,992	100.00%	\$4,271,992
Per CareFirst *	4,282,785	87.80%	3,760,472
<b>Difference</b>			<b>\$511,520</b>

\* CareFirst's computations dated 5/15/07.

**RECOMMENDATIONS**

We recommend that CareFirst:

- decrease Medicare segment pension assets as of December 31, 2005, by \$10,793;
- increase Medicare’s share of the excess Medicare segment pension assets as of December 31, 2005, by \$511,520; and
- refund to the Federal Government \$4,271,992, which we calculated to be Medicare’s share of the Medicare segment excess pension assets as of the termination of the Medicare contracts.

**AUDITEE COMMENTS**

In written comments on our draft report, CareFirst concurred with our first recommendation but disagreed with our second and third recommendations. CareFirst recomputed \$3,750,809 as Medicare’s share of the Medicare segment excess pension assets as of December 31, 2005.

CareFirst stated that our calculation of Medicare’s share of the “. . . surplus Medicare pension segment assets does not take into account that CMS did not fully participate in the funding of those assets.” CareFirst said that it “. . . incurred administrative costs in excess of its Notice of Budget Approval (NOBA) amount, and that CareFirst did not receive reimbursement [from

CMS] for its over-NOBA costs.” CareFirst added that “. . . the [Federal] Government did not fully participate in the initial funding of CareFirst’s Medicare segment assets.”

Having offered these statements and related information about the initial funding of CareFirst’s Medicare segment assets, CareFirst added that its “. . . situation is unique . . .” which “. . . makes the application of a strict pension cost calculation inaccurate and is not the intent of CAS 413.” CareFirst stated that accordingly, “. . . business judgment, not rigid accounting principles, should govern the settlement of terminations . . .” and it cited FAR 49.201 in making this argument.

In addition to commenting on our recommendations, CareFirst added comments about its postretirement benefits [PRB] program, “. . . which is not addressed in either of the OIG’s [Office of Inspector General] draft reports. . . . CareFirst believes that [its] PRB liability should be offset against the pension surplus in calculating the remaining amount due the Government.”

CareFirst’s comments are included in their entirety as Appendix C.

## **OFFICE OF INSPECTOR GENERAL RESPONSE**

After reviewing CareFirst’s written comments, we continue to support all of our findings and recommendations, including our recommendation that CareFirst refund to the Federal Government \$4,271,992, which we calculated to be Medicare’s share of the Medicare segment excess pension assets as of the termination of the Medicare contracts.

Other than the appeal to FAR 49.201 and the argument that business judgment rather than accounting principles should govern the settlement of terminations, CareFirst’s comments offered substantively the same arguments that CareFirst officials raised, and that we considered, during our review. Notwithstanding CareFirst’s stated belief that the Federal Government had not fully participated in the initial funding of the Medicare segment assets, the computations that CareFirst undertook in keeping with this stated belief did not fully comply with the pension-cost-only methodology specified by CAS 413. Specifically, CareFirst’s approach considered asset values, which included factors other than pension costs, in its methodology. Accordingly, and because CareFirst’s approach did not fully comply with the provisions of CAS 413, we did not change our findings, we did not incorporate CareFirst’s recomputed figure of \$3,750,809 into those findings, and we did not modify our recommendations.

With respect to CareFirst’s related statement regarding FAR 49.201, we acknowledge that although part 49 language may not technically apply, both the FAR and relevant statutes support the general principle that the CMS contracting officer has the authority to use discretion and business judgment in addressing and compromising contract claims. However, this authority, in our view, cannot be read to override basic applicable FAR provisions, including CAS 413, which requires calculation of Medicare segment assets under the pension-cost-only method. For our part, we held to the provisions of CAS 413 when calculating CareFirst’s Medicare segment assets, and our findings and recommendations reflect that fact.

With respect to the PRB issue, we have informed CareFirst that the PRB claim will be addressed separately in a future report.

# **APPENDIXES**

**MARKET VALUE OF PENSION ASSETS  
FOR THE PERIOD  
JANUARY 1, 2002, TO DECEMBER 31, 2005**

Description	Total Company	Other Segment	Medicare Segment
Assets January 1, 2002	<u>1/</u> \$103,199,635	\$90,646,028	\$12,553,607
Contributions	<u>2/</u> 10,868,123	10,868,123	0
Earnings	<u>3/</u> (13,801,443)	(12,131,601)	(1,669,842)
Benefit payments	<u>4/</u> (8,196,365)	(7,709,643)	(486,722)
Expenses	<u>5/</u> (740,811)	(651,180)	(89,631)
Transfers	<u>6/</u> 0	1,496	(1,496)
Other transactions	<u>7/</u> 203,598,056	203,598,056	0
Assets January 1, 2003	294,927,195	284,621,279	10,305,916
Contributions	64,555,250	64,555,250	0
Earnings	65,054,840	62,774,951	2,279,889
Benefit payments	(16,952,717)	(16,692,800)	(259,917)
Expenses	(1,401,932)	(1,352,800)	(49,132)
Transfers	0	(153,310)	153,310
Other transactions	0	0	0
Assets January 1, 2004	406,182,636	393,752,570	12,430,066
Contributions	24,495,840	24,495,840	0
Earnings	41,957,009	40,750,844	1,206,165
Benefit payments	(23,033,016)	(21,294,301)	(1,738,715)
Expenses	(2,637,426)	(2,561,606)	(75,820)
Transfers	0	89,128	(89,128)
Other transactions	(30,128,184)	(30,128,184)	0
Assets January 1, 2005	416,836,859	405,104,291	11,732,568
Contributions	13,370,000	13,370,000	0
Earnings	21,057,729	20,471,284	586,445
Benefit payments	(36,464,309)	(35,253,313)	(1,210,996)
Expenses	(2,041,661)	(1,984,802)	(56,859)
Transfers	0	1,075,710	(1,075,710)
Other transactions	0	0	0
Assets December 31, 2005	(\$4,078,241)	(\$2,321,121)	(\$1,757,120)
Per CareFirst	<u>8/</u> \$412,758,618	\$402,772,377	\$9,986,241
Asset variance	<u>9/</u> (\$416,836,859)	(\$405,093,498)	(\$11,743,361)

**FOOTNOTES**

- 1/ We determined the Medicare segment assets as of January 1, 2002, in our prior audit (A-07-02-03033). The amounts shown for the Other segment represent the difference between the Total Company segment 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. 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 CareFirst's benefit payments to Medicare segment retirees.
- 5/ We allocated administrative expenses to the Medicare segment in proportion to investment earnings.
- 6/ CareFirst made adjustments for participant transfers between segments. We accepted its calculations.
- 7/ We obtained "Other" transaction information from the actuarial valuation reports. "Other" transactions represent plan merger and plan spinoff activities.
- 8/ We obtained total asset amounts as of December 31, 2005, from documents prepared by CareFirst's actuarial consulting firm.
- 9/ The asset variance represents the difference between our calculation of Medicare segment assets and CareFirst's market value of assets.

## CALCULATION OF AGGREGATE MEDICARE PERCENTAGE

Fiscal Year <u>1/</u>	Medicare Segment		Medicare's Aggregate % (A/B) <u>2/</u>
	Pension Costs Charged to Medicare (A)	Total Medicare Segment Pension Costs (B)	
1988	\$91,987	\$91,987	
1989	73,535	73,535	
1990	32,149	32,149	
1991	38,015	38,015	
1992	0	0	
1993	0	0	
1994	0	0	
1995	0	0	
1996	0	0	
1997	0	0	
1998	0	0	
1999	0	0	
2000	0	0	
2001	0	0	
2002	0	0	
2003	0	0	
2004	0	0	
2005	0	0	
<b>Total</b>	<b>\$235,686</b>	<b>\$235,686</b>	<b>100.00%</b>

1/ We obtained information for fiscal years (FY) 1988–1991 from our prior pension costs claimed audit (A-07-93-00694) and information for FYs 1992–2001 from our later pension costs claimed audit (A-07-02-03036). We obtained information for FYs 2002–2005 during our current pension costs claimed audit (A-07-07-00244).

2/ We calculated the aggregate Medicare percentage by dividing the Medicare segment pension costs charged to Medicare (numerator) by the total Medicare segment pension costs (denominator) pursuant to Cost Accounting Standard 413. CareFirst's aggregate Medicare percentage considered reimbursement levels of the segment's pension costs. Because of the relationship between segment pension costs and segment pension assets, our calculations assumed 100-percent reimbursement of pension costs.

**William V. Stack**  
Vice President and  
Corporate Controller

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October 31, 2008

Office of the Inspector General  
Office of Audit Services  
Department of Health and Human Services  
Region VII  
601 East 12<sup>th</sup> Street  
Room 284A  
Kansas City, Missouri 64106

Re: Audit Report A-07-07-00243

Dear Mr. Cogley:

CareFirst of Maryland, Inc., d/b/a CareFirst BlueCross BlueShield ("CareFirst") submits this letter as its response to the above referenced draft report entitled "Review of the Qualified Pension Plan at CareFirst of Maryland, Incorporated, a Terminated Medicare Contractor, for the Period January 1, 2002, to December 31, 2005" (the "Draft Pension Surplus Report").

**Recommendation 1:**

The Draft Pension Surplus Report recommends that CareFirst "decrease Medicare segment pension assets as of December 31, 2005 by \$10,793." CareFirst concurs with this recommendation and will make appropriate adjustments that reflect this recommendation in CareFirst's final settlement proposal that will be submitted in connection with the termination of CareFirst's Medicare A contract.

**Recommendations 2 and 3:**

The Draft Pension Surplus Report states that "CareFirst did not fully comply with Federal requirements in its calculation of Medicare's share of the Medicare segment excess pension assets associated with the termination of the Medicare contracts," and that "CareFirst understated Medicare's share [of the surplus pension assets] by \$511,520." In addition, the Draft Pension Surplus Report recommends that CareFirst "refund to the Federal Government \$4,271,992, which [the OIG] calculated to be Medicare's share of the Medicare segment excess pension assets as of the termination of the Medicare contracts."

CareFirst disagrees with these recommendations because the auditors' calculation of Medicare's share of CareFirst's surplus Medicare pension segment assets does not take into account that CMS did not fully participate in the funding of those assets. Specifically, CMS did not fully reimburse CareFirst's allowable pension costs claimed on its Final Administrative Cost Proposals (FACPs) from 1988 to 1991<sup>1</sup>.

During the OIG's May 2007 field work, CareFirst provided the auditors with documentation from its FY 1989 – 1995 administrative cost settlement agreements for its Fiscal Intermediary and Carrier contracts. Those documents identified that CareFirst incurred administrative costs in excess of its Notice of Budget Approval (NOBA) amount, and that CareFirst did not receive reimbursement for its over-NOBA costs.

As the following table illustrates, CareFirst was reimbursed only 97.54% of its total administrative costs incurred from FY 1989 to 1991<sup>2</sup>.

Fiscal Year	Part A/B	Admin Costs Reimbursed	Admin Costs Incurred	Difference	Percentage Reimbursed
1989	Part A	\$ 6,627,096	\$ 6,925,310	\$ (298,214)	95.69%
1989	Part B	17,534,601	18,017,866	(483,265)	97.32%
		24,161,697	24,943,176	(781,479)	96.87%
1990	Part A	7,035,784	7,266,605	(230,821)	96.82%
1990	Part B	15,561,303	15,950,158	(388,855)	97.56%
		22,597,087	23,216,763	(619,676)	97.33%
1991	Part A	7,060,922	7,225,726	(164,804)	97.72%
1991	Part B	18,616,196	18,880,766	(264,570)	98.60%
		25,677,118	26,106,492	(429,374)	98.36%
<b>Total</b>		<b>\$ 72,435,902</b>	<b>\$ 74,266,431</b>	<b>\$ (1,830,529)</b>	<b>97.54%</b>

Source: CareFirst Administrative Cost Settlement Agreements 10 and 11, FYs 1989-1995

Because pension costs are a category of administrative costs that are claimed and reimbursed through the FACP submission process, CareFirst maintains that the percentage of pension costs reimbursed by CMS mirrors that of CareFirst's annual administrative cost reimbursement. The OIG did not dispute that CareFirst was reimbursed less than its total administrative costs. Therefore, it is unreasonable to conclude that CMS reimbursed 100-percent of CareFirst's pension costs while rejecting its other over-NOBA administrative costs. The Draft Pension Surplus Report states in Appendix B Note 2, however, that "our calculations assumed 100-percent reimbursement of pension costs."

<sup>1</sup> CareFirst did not incur direct segment pension costs after 1991 because CareFirst's Medicare segment assets were overfunded.

<sup>2</sup> Note that because CareFirst can no longer locate accounting records to support its incurred and reimbursed FY 1988 administrative costs, CareFirst assumes its 1988 reimbursement is consistent with the average administrative cost reimbursement percentage for FY 1989 to FY 1991.

CareFirst strongly believes that the foregoing information should be taken into consideration in determining an equitable calculation of the amount of surplus assets that should be refunded to Medicare.

Furthermore, CareFirst maintains that the Government did not fully participate in the initial funding of CareFirst's Medicare segment assets. Documentation from the 1981 Medicare segment asset fraction calculation that CareFirst provided to the OIG identifies that the government only funded 87.29% of the segment's initial actuarial liabilities. To be clear, CareFirst is not disputing the calculation of the initial asset fraction, which was agreed to in a prior audit. The purpose of that audit did not include the determination of the Government participation, but with the closure of the segment, the Government's participation is critical in determining the appropriate distribution of the segment assets. This situation is unique because contractual requirements resulted in initial assets that were not accumulated based upon the pension costs charged prior to 1988. This circumstance makes the application of a strict pension cost calculation inaccurate and is not the intent of CAS 413.

CareFirst has submitted information which indicates that the Government did not participate 100% in the Medicare segment prior to 1988. Specifically, CareFirst identified several employees that were counted as part of the Medicare segment, but whose salaries were either excluded from or only partially charged to CareFirst's Medicare line of business. Since these employees' salary and fringe benefit costs were not charged to Medicare, the government did not reimburse CareFirst for their associated pension liabilities. Accordingly, the government should only be entitled to 87.29% of the December 31, 2005 value of the surplus assets resulting from the initial segment funding.

CareFirst's position regarding this issue is supported by FAR 49.201 which provides that business judgment, not rigid accounting principles, should govern the settlement of terminations:

- (a) A settlement should compensate the contractor fairly for the work done and the preparations made for the terminated portions of the contract, including a reasonable allowance for profit. Fair compensation is a matter of judgment and cannot be measured exactly. In a given case, various methods may be equally appropriate for arriving at fair compensation. The use of business judgment, as distinguished from strict accounting principles, is the heart of a settlement.
- (b) The primary objective is to negotiate a settlement by agreement. The parties may agree upon a total amount to be paid the contractor without agreeing on or segregating the particular elements of costs or profit comprising this amount.
- (c) Costs and accounting data may provide guides, but are not rigid measures, for ascertaining fair compensation. In appropriate cases, costs may be estimated, differences compromised, and doubtful questions settled by agreement. Other types of data, criteria, or standards may furnish equally reliable guides to fair compensation. The amount of recordkeeping, reporting, and accounting related to the settlement of terminated contracts

should be kept to a minimum compatible with the reasonable protection of the public interests.

Applying the principles of FAR 49.201 to all of the findings discussed above, CareFirst has determined that the Government only reimbursed 87.80% of CareFirst's Medicare segment pension costs. This calculation is reflected in the following table:

Fiscal Year	Medicare Segment Pension Costs <b>I</b>	Percent Reimbursement <b>II=III/I</b>	CMS Reimbursed Pension Cost <b>III</b>
Initial Assets	\$ 4,435,729	87.29%	\$ 3,872,070
1988	91,987	97.54%	89,720
1989	73,535	96.87%	71,231
1990	32,149	97.33%	31,291
1991	38,015	98.36%	37,390
1992 - 2005	-	N/A	-
<b>Total*</b>	<b>\$ 4,671,415</b>	<b>87.80%</b>	<b>\$ 4,101,702</b>

\*The total percent reimbursed is calculated by dividing the total Medicare Segment pension cost by the total CMS reimbursement of pension costs (rounded to two decimal places).

<b>Excess Pension Assets</b>	<b>\$ 4,271,992</b>
<b>Government Adjustment Percentage</b>	<b>87.80%</b>
<b>Government Share of Surplus Assets</b>	<b>\$ 3,750,809</b>

We believe this calculation is consistent with the business judgment rule and provides an equitable result for CareFirst and the Government.

**Post Retirement Benefits (PRB) Program**

In addition to the points discussed above, CareFirst would also like to address its position related to its Post Retirement Benefits program, which is not addressed in either of the OIG's draft reports.

CareFirst has always maintained a Post Retirement Benefit (PRB) program for its employees, including the employees of its Medicare segment. The PRBs include certain medical, dental and life insurance benefits for its retired employees. The benefits extend to covered retirees, covered spouses and covered dependents. CareFirst has and will continue to pay for these benefits past termination.

As noted above, a concept central to termination proceedings is that the Contracting Officer should exercise business judgment to assure equitable treatment of the contractor. Such treatment necessarily includes actions which assure that the contractor is made whole, which in this case means consistent with the statutorily-imposed requirements of contract which states that the Intermediary not incur a loss. As of January 1, 2006, CareFirst has determined that its post retirement benefits liability is \$1,543,972. CareFirst has provided the documentation for the Medicare segment PRB liabilities and requests that OIG and CMS give consideration for the liability generated by CareFirst's long service to the Medicare program. CareFirst believes that this PRB liability should be offset against the pension surplus in calculating the remaining amount due to the Government.

**Summary**

In conclusion, the following calculation represents the amount of the Medicare surplus pension assets that are due to the Government in connection with the termination of CareFirst's Medicare A contract:

\$ 4,271,992	OIG's Calculation of Surplus
<u>x 87.8%</u>	Percentage of Government Pension Reimbursement
\$ 3,750,809	Surplus Pension Assets
<u>- \$ 1,543,972</u>	Less: Post Retirement Benefits
<b>\$ 2,206,837</b>	<b>Balance Due CMS</b>

If you have any questions regarding this response, please contact me at (410) 998-7011. We appreciate your consideration of the issues raised in our response.

Sincerely,



William V. Stack  
Vice President  
and Corporate Controller